INDIANA DEPARTMENT OF ENVIRONMENTAL MANAGEMENT

Title: Extension for Non-Major Source Part 70 Permit Applications
Identification Number: AIR-026-NPD
Date Effective: November 3, 2000
Dates Revised: None
Other Policies Repealed or Amended: None
Brief Description of Subject Matter: Extension of application deadline for Part 70 permits for non-major (area) sources subject to the following federal National Emission Standards for Hazardous Air Pollutants (NESHAP):

(1) Hard and decorative chromium electroplating and chromium anodizing tanks (40 CFR Subpart N);
(2) Ethylene oxide commercial sterilization and fumigation operations (40 CFR 63, Subpart O);
(3) Perchloroethylene dry cleaning facilities (40 CFR 63, Subpart M);
(4) Halogenated solvent cleaning machines (40 CFR 63, Subpart T);
(5) Secondary lead smelting (40 CFR 63, Subpart X); and
(6) Secondary aluminum production (40 CFR 63, Subpart RRR).

Citations Affected: 326 IAC 20-5-1; 20-6-1; 20-7-1; 20-8-1; and 20-13-1

This nonrule policy document is intended solely as guidance and does not have the effect of law or represent formal Indiana Department of Environmental Management (IDEM) decisions or final actions. This nonrule policy document shall be used in conjunction with applicable laws. It does not replace applicable laws, and if it conflicts with these laws, the laws shall control. This nonrule policy document may be put into effect by IDEM thirty days after presentation to the appropriate board and after it is made available to public inspection and comment, pursuant to IC 13-14-1-11.5. If the nonrule policy is presented to more than one board, it will be effective thirty days after presentation to the last. IDEM will submit the policy to the Indiana Register for publication. Revisions to the policy will follow the same procedure of presentation to the board and publication.

The purpose of this nonrule policy document is to clarify enforcement policy with respect to 326 IAC 2-7-4(a) as it applies to area sources in the source categories identified above. As per 61 FR 27785 (June 3, 1996), area sources in the aforementioned source categories, excluding secondary aluminum production, had been granted a deferral from the Part 70 permit application deadline until December 9, 2000. U.S. EPA has granted permitting authorities discretion to extend the application deadline until December 9, 2005, pursuant to an amendment to 40 CFR Part 63, Subparts M, N, O, T and X, published in the Federal Register at 64 FR 69637 (December 14, 1999).

In addition to the source categories included in the December 14, 1999 Federal Register notice, U.S. EPA has granted permitting authorities similar discretion with respect to area sources subject to the Secondary Aluminum Production NESHAP, 40 CFR 63, Subpart RRR, published in the Federal Register at 65 FR 15689 (March 22, 2000).

IDEM has decided to exercise this discretion as it applies to the aforementioned source categories and hereby extends the deadline for Part 70 permit applications to December 9, 2005. IDEM will not issue a notice of violation (NOV) or take other enforcement action against area sources in the aforementioned source categories for failure to submit a Part 70 permit application by December 9, 2000.

This policy will remain in effect until December 9, 2005.

If you have any questions concerning this policy, please contact:

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Copies of this policy will be on file after October 4, 2000 at the Office of Air Management, Indiana Department of Environmental Management, Indiana Government Center-North, 100 North Senate Avenue, Twelfth Floor File Room, Indianapolis, Indiana and are open for public inspection.

This policy, along with other nonrule policy documents, can also be found online at www.state.in.us/idem/oam/nrpd.

DEPARTMENT OF STATE REVENUE
Information Bulletin #69
Sales Tax
December 1999

DISCLAIMER: Information bulletins are intended to provide nontechnical assistance to the general public. Every attempt is made to provide information that is consistent with the appropriate statutes, rules and court decisions. Any information that is not consistent with the law, regulations or court decisions is not binding on either the Department or the taxpayer. Therefore, the information

provided herein should serve only as a foundation for further investigation and study of the current law and procedures related to the subject matter covered herein.

SUBJECT: COMMERCIAL PRINTERS

REFERENCE: IC 6-2.1-2-4; IC 6-2.5-5-3; IC 6-2.5-5-4; IC 6-2.5-5-5.1; IC 6-2.5-5- 6; IC 6-2.5-5-36; IC 6-2.5-8-8.5

INTRODUCTION

This bulletin is to explain the tax exemption for items purchased by commercial printers.

TAX EXEMPTIONS FOR ITEMS PURCHASED BY COMMERCIAL PRINTERS:

IC 6-2.5-5-3 provides that "commercial printing as described in IC 6-2.1-2-4 shall be treated as the production and manufacture of tangible personal property." Commercial printing that is described in IC 6-2.1-2-4 is "the business of commercial printing that results in printed materials, excluding the business of photocopying." A commercial printer is, therefore, entitled to an exemption for machinery, tools and equipment that are directly used to perform a process or activity, or both, that is related to the production of printed materials for others. This includes equipment, e.g., computers, scanners, etc., that is used to perform what is commonly referred to as pre-press activities, which include the receiving, processing, moving, storing, and transmitting, either physically or electronically, of copy elements and images to be reproduced, and plate-making or cylinder-making. Exempt pre-press activities do not include drafting of copy or the creation of artwork for reproduction.

Commercial printers are also exempt from sales/use tax on purchases of capital equipment, consumables, and materials used in commercial printing under IC 6-2.5-5-4, IC 6-2.5-5-5.1 and IC 6-2.5-5-6. Each of these exemptions cross-references back to IC 6-2.1-2-4. Like any other manufacturers, commercial printers may also be exempt from tax under other sections of the Code.

A business or part of a business that performs one or more, but not all, of the processes or activities related to the production of printed materials (such as a pre-press house) is also exempt from sales and use tax on its purchases of machinery, tools and equipment, consumables, and materials, etc., to the same extent that a business that performs all such commercial printing processes or activities would be exempt on its purchases of the same items. An exempt process or activity related to the production of printed materials should not become taxable simply because it is performed by an entity separate from the entity that performs the rest of the commercial printing processes or activities. Photocopying is expressly excluded from the type of commercial printing that is entitled to exemption under IC 6-2.5-5-3, -4, -5.1 and –6.

A commercial printer must collect and remit Indiana sales tax on the full price charged to the customer for the tangible personal property sold, unless the transaction is otherwise exempt from tax or the customer provides a direct pay permit, exemption certificate or a statement under IC 6-2.5-8-8.5.

Kenneth L. Miller
Commissioner

DEPARTMENT OF STATE REVENUE

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LETTER OF FINDINGS NUMBER 93-0383
Controlled Substance Excise Tax
For Tax Period: April 12, 1993

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning specific issues.

ISSUE

Controlled Substance Excise Tax – Imposition

Authority: IC 6-7-3-5; IC 6-7-3-6(b); IC 6-8.1-5-1(b); *Bryant v. State of Indiana*, 660 N.E.2d 290 (Ind. 1995)

Taxpayer protests the imposition of the Controlled Substance Excise Tax.

STATEMENT OF FACTS

Following a search conducted pursuant to a search warrant in which approximately 100 marijuana plants and a number of bags containing marijuana were found, Taxpayer was arrested in April 1993 by officers from the Lawrence County Sheriff's Department and charged with two counts of possession of marijuana (Class D Felony) and one count of maintaining a common nuisance (Class D Felony). The Department assessed the Controlled Substance Excise Tax on April 12, 1993 after the field test showed a positive test for marijuana. The assessment was based on 1,936.2 grams of marijuana, a Schedule I drug. In August 1993, as part of a plea agreement, Taxpayer pled guilty to one count of possession of marijuana (IC 35-48-4-11) and was sentenced in October 1993. Taxpayer protests this assessment, and a hearing was held. Further facts will be provided as necessary.

DISCUSSION

IC 6-7-3-5 states:

"The controlled substance excise tax is imposed on controlled substances that are: (1) delivered; (2) possessed; or (3) manufactured in Indiana in violation of IC 35-48-4 or 21 U.S.C. 841 through 21 U.S.C. 852…"

IC 6-8.1-5-1(b) states:

"…The notice of proposed assessment is prima facie evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made."

Taxpayer first argues that the assessment of the Controlled Substance Excise Tax is excessive. At the time of the Taxpayer's arrest and the Department's issuance of the jeopardy assessment, IC 6-7-3-6(b) levied the Controlled Substance Excise Tax at a rate of forty dollars ($40) per gram for a Schedule I drug, of which marijuana falls into that category. The Taxpayer was taxed at the statutory rate, no more. The Controlled Substance Excise Tax has not been excessively assessed to the Taxpayer.

Taxpayer next argues that the imposition of the Controlled Substance Excise Tax constitutes double jeopardy because the Taxpayer has already pled guilty to a charge of possession of marijuana as a result of the search conducted on his residence. As the Indiana Supreme Court held in *Bryant v. State of Indiana,* the imposition of the Controlled Substance Excise Tax is a jeopardy for double jeopardy purposes. *Bryant*, 660 N.E.2d at 297. In this case jeopardy attached on April 12, 1993 when the Department issued a jeopardy assessment against the Taxpayer for the Controlled Substance Excise Tax. Taxpayer did not plead guilty to the criminal charge of possession of marijuana under IC 35-48-4-11 until August 16, 1993 and was subsequently sentenced on October 13, 1993. The assessment of the Controlled Substance Excise Tax was the first jeopardy to attach. Thus, the imposition of the Controlled Substance Excise Tax does not constitute double jeopardy for the Taxpayer in this instance.

The Fourth Circuit United States Court of Appeals case of *Lynn v. West*, 134 F.3d 582 (4th Cir. 1998) is cited by the Taxpayer as his final argument. The *Lynn* Court did hold that North Carolina's drug tax was a criminal penalty as opposed to a civil tax, and, as such, the enforcement of the tax had to conform to all the constitutional safeguards that accompany criminal proceedings. *Lynn,* 134 F.3d at 589. *Lynn*, however, is not binding on the Department or courts in the State of Indiana.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

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LETTER OF FINDINGS NUMBER: 97-0174
Sales Tax
For Tax Periods 1992-1995

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales Tax – Sale/Leasebacks

Authority: Monarch Beverage Company, Inc. v. Indiana Dept. of Revenue, 589 N.E.2d 1209 (Ind. Tax 1992); IC 6-2.5-5-8; 45 IAC 15-3-2(3); Information Bulletin #42

Taxpayer protests imposition of sales tax on purchase and sale/leaseback of restaurant equipment.

II. Tax Administration – Interest

Authority: IC 6-8.1-10-1

Taxpayer protests imposition of interest on proposed assessments.

III. Tax Administration – Negligence Penalty

Authority: 45 IAC 15-11-2

Taxpayer protests imposition of a ten percent (10%) negligence penalty.

STATEMENT OF FACTS

Taxpayer owns and operates fast food restaurants in Indiana and throughout the country. During the audit period, taxpayer built several restaurants in Indiana and sold the Furniture, Fixtures and Equipment (FF&E) to investors who then leased the FF&E back to taxpayer. The Indiana Department of Revenue (the Department), assessed sales tax on taxpayer's original purchase and on the taxpayer's lease from the financial institutions which bought the restaurants from taxpayer. Taxpayer believes that only the lease back from the investor is taxable.

I. Sales Tax – Sale/Leasebacks

DISCUSSION

Taxpayer protests the assessment of sales tax on its original purchase of Furniture, Fixtures and Equipment (FF&E) for fast food restaurants it built and operated in Indiana during the audit period. Taxpayer built the restaurants and sold the FF&E to various

investors who then leased the equipment back to taxpayer. Taxes were not collected on the sale to the investors per IC 6-2.5-5-8, which states in part:

> Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of his business without changing the form of the property.

Sales taxes were paid when taxpayer leased the property back from the investors. Sales taxes were not collected on the equipment when taxpayer made the original purchases. Taxpayer provided exemption certificates to its suppliers. Taxpayer viewed the purchase and sale/leaseback as one three-way transaction. Taxpayer states that since it always intended to treat these purchases as a sale/leaseback, the initial purchase is not subject to sales tax.

The Department considered the original purchases to be a separate transaction from the sale/leaseback and assessed sales tax on the original purchases. The auditor relied on Monarch Beverage Co., Inc., 589 N.E.2d 1209 (Ind. Tax 1992), which states, "Therefore, sales or use tax can be collected more than once on the same item if the item is the subject of more than one non-exempt retail transaction." Monarch Beverage concerned a beverage distribution company that contracted with a trailer manufacturer to purchase several trailers to transport its products. Monarch ordered the trailers and specified that a third party would pay the manufacturer for the trailers.

When the manufacturer delivered the trailers to Monarch, no third party had been found. Monarch paid the use tax to the Bureau of Motor Vehicles for the trailers, without paying the manufacturer the purchase price, in order to obtain license plates for the trailers. Forty-Six (46) days later, a third party paid the manufacturer the purchase price for the trailers, took title to the trailers, then leased them to Monarch. Sales tax was due on the lease payments and Monarch applied for a refund of the use tax it had paid for the license plates, claiming that it was being taxed twice on the same items. After its protest was denied at the administrative level, Monarch appealed to the Tax Court of Indiana. The Court ruled that two taxable events had occurred. The first was when Monarch had taken possession of the trailers and used them in its business. The second was when Monarch leased the trailers from the third party.

The Department of Revenue viewed the purchase and the leaseback in the instant case as more than one non-exempt retail transaction, since the taxpayer bought the equipment, used it by operating the restaurants, then sold it and leased it back. In the view of the Department, the intent of the taxpayer to treat the three transactions as one three-part transaction was defeated by the fact that taxpayer used the equipment prior to selling it.

Taxpayer refers to several Revenue Rulings issued prior to the Monarch Beverage decision to support its position. Taxpayer states in its protest letter, "While these rulings pre-date the *Monarch Beverage Company, Inc.* case there is no indication that any of these taxpayer favorable rulings have been overturned." The Department refers to 45 IAC 15-3-2(d)(2), which states in part:

> The department may exercise its discretion to retroactively rescind or modify rulings in the following extreme circumstances, which are not all inclusive:
>
> (A) There was a misstatement or omission of material facts.
>
> (B) The facts, as developed after the ruling, were materially different from the facts on which the department based its ruling.
>
> (C) *There was a change in the applicable statute, case law or regulation.*
>
> (D) The taxpayer directly involved in the ruling did not act in good faith.
>
> Taxpayers are cautioned that changes in the law and final decisions of Appellate Court, Supreme Court and Indiana Tax Court cases are notification to the taxpayer of a possible revocation of a ruling, effective from the date of the court decision or change in the law within the statutory open period. (Emphasis added.)

The Monarch Beverage decision was issued on April 7, 1992. The first piece of equipment to have sales tax assessed as a result of the audit was purchased in 1993. Therefore, taxpayer was on notice that the rulings it relied on were superceded prior to its purchase of the FF&E for its restaurants.

Taxpayer believes that its intent to create a single three-way transaction should control how the sales tax is applied. Taxpayer supported this position by pointing out that it always issued exemption certificates to the sellers of the equipment it was purchasing. Taxpayer also provided copies, with its original protest letter, of three documents from the lending institutions it dealt with. Taxpayer explained that these commitment letters show that it intended to sell the restaurant equipment to the lenders before it was purchased, and then lease it back. Of the three documents, two contain no description of the location of the equipment to be purchased by the lender. The other lender, hereafter "Lender One", lists the location for the equipment as "Equipment to be located in no more than four (4) of the Lessee's [Name deleted] franchise locations in the Continental United States." There is no language establishing that the location of the equipment is in Indiana.

The other two documents are not commitment letters. The first of these lenders, hereafter "Lender Two", has a paragraph in its document that states, "The foregoing is a proposal only and does not constitute a commitment to finance until approved by [Lender Two]'s Credit Committee." The other lender, hereafter "Lender Three", has a paragraph in its document that states, "LESSEE further acknowledges that this proposal is not intended and shall not be construed as a commitment by [Lender Three] and that any commitment is subject to [Lender Three]'s review and written approval."

Also included with the original protest letter was a "Lease Closing Schedule" from Lender Three. This document does list the location of the restaurant concerned, also referred to as "#6367", as being in Indiana. The closing date of the closing schedule is April 20, 1995. The Audit Report shows that the last piece of equipment purchased for unit #6367 occurred on November 30, 1994. This means that there was

a difference of one hundred and forty (140) days between the date of the final invoice and the closing date for the lease.

The Department pointed out this 140-day gap between purchase and sale/leaseback to taxpayer in a letter issued at a stage in the administrative process prior to the administrative hearing. Taxpayer responded by providing a copy of another document from Lender Three, dated February 28, 1994, and signed on March 10, 1994 by taxpayer, stating that there was a commitment letter in place at the time of construction for unit #6367.

This document is not a commitment letter. As with the previously discussed letter from Lender Three, there is a paragraph in this document which states, "LESSEE further acknowledges that this proposal is not intended and shall not be construed as a commitment by [Lender Three] and that any commitment is subject to [Lender Three]'s review and written approval." Furthermore, nowhere on this document is there a location or even a unit number provided to establish which restaurant's equipment is being discussed, or even if the location is in Indiana.

Taxpayer protests the "double taxation" of the equipment in question. The Monarch Beverage decision explains that, "Therefore, sales or use tax can be collected more than once on the same item if the item is the subject of more than one non-exempt retail transaction." (Id., at 1214.) The court also explained its reasoning as follows:

> Furthermore, the Legislature intended sales and use taxes as end use taxes imposed on ultimate user/consumers, indicated by providing exemptions that prevent tax pyramiding, *i.e*., taxing items sold during the intermediate stages of production, prior to completion of the end product:
>
> > 'All sales tax laws exempt or exclude some retail sales. The reasons for this treatment vary. Goods used in the manufacturing process are exempt entirely or partially by all state laws to avoid tax pyramiding, that is, the situation where a tax is levied on a tax and the result is a retail price increase greater than the amount of the tax.'
>
> *General Motors Corp. v. Indiana Dep't of State Revenue* (1991), Ind. Tax, 578 N.E.2d 399, 405 (quoting *Welsh v. Sells*, 244 Ind. At 434-35, 192 N.E.2d at 759-60).
>
> Monarch is the ultimate user/consumer of the trailers. Taxing the finished trailers more than once therefore does not offend the legislature's policy against tax pyramiding.

Id., at 1214-15

Taxpayer urges the Department to observe the substance over the form of the transactions. Here, the substance of the transactions is that taxpayer bought tangible personal property in a retail transaction and started using it by operating the restaurants. Then, taxpayer sold the property and leased it back from the businesses it sold the property to and used it. This makes the taxpayer the end user in two separate taxable events.

Taxpayer believes that the FF&E should be exempt from the retail sales tax as the original purchase was a sale for resale. Taxpayer states that it always intended to resell the property. The Department refers to 45 IAC 2.2-5-15, which states:

> (a) The state gross retail tax shall not apply to sales of any tangible personal property to a purchaser who purchases the same for the purpose of reselling, renting or leasing, in the regular course of the purchaser's business, such tangible personal property in the form in which it is sold to such purchaser.
>
> This regulation also explains:
>
> (c) Application of general rule.
>
> > (1) The tangible personal property must be sold to a purchaser who makes the purchase with the intention of reselling, renting or leasing the property. *This exemption does not apply to purchasers who intend to consume or use the property or to add value to the property through the rendition of services or performance of work with respect to such property.* (Emphasis added.)

Taxpayer has supplied documentation to establish that the equipment was purchased in the regular course of its business. Subsection (c) of this regulation specifically states that the exemption does not apply to purchasers who intend to use the property. Taxpayer provided documentation to support its position that it was in the business of building and operating restaurants. Taxpayer also explained in its protest letter that there is usually a delay between the completion of a restaurant and its sale to an investor. Therefore, taxpayer did intend to use the property prior to title transferring to the lenders.

Taxpayer refers to Information Bulletin #42, issued in June, 1995, example (5) in the category "OTHER SIMILAR TRANSACTIONS SUBJECT TO SALES TAX", which lists, "Tangible personal property initially purchased for a nonexempt purpose and subsequently used as rental property." Taxpayer believes that since its intention was to treat the purchases as a sale/leaseback, the initial purchases were for an exempt purpose, therefore example (5) does not apply and those purchases were not subject to sales tax.

Information Bulletin #42 deals with sales tax as it applies to rental and leasing of tangible personal property. The introduction of the Information Bulletin states:

A lessor engaged in the business of renting or leasing tangible personal property in Indiana must register as a retail merchant with the Indiana Department of Revenue. Every lessor is required to collect and remit the Indiana gross retail tax (5%) on the price of the rental or lease contract.

Taxpayer is the lessee in the sale/leaseback, not the lessor. The various lenders taxpayer sold the equipment to are the lessors. Taxpayer stated in its protest letter and at hearing that it believes that the leaseback of the property is taxable. Example (5) concerns

the purchases by the lessors (lenders), not the lessee (taxpayer). From the perspective of the lenders, the property was used as rental property, and therefore properly subject to sales tax when leased.

To conclude, while taxpayer may have intended to conduct a single transaction with three steps, the result is that three transactions took place. The first was the initial purchase and use of the equipment, which is a taxable transaction. The second was the sale of the equipment to the various lenders. The lenders purchased the equipment in order to rent it, therefore this transaction is exempt. The third transaction was the equipment rental by the purchasers (lessor) to taxpayer (lessee), which is a second taxable transaction.

FINDING

Taxpayer's protest is denied.

II. Tax Administration – Interest

Taxpayer protests the imposition of interest on the amount assessed in the audit. IC 6-8.1-10-1(a) provides:

If a person fails to file a return for any of the listed taxes, fails to pay the full amount of tax shown on his return by the due date for the return or the payment, or incurs a deficiency upon a determination by the department, the person is subject to interest on the nonpayment.

IC 6-8.1-10-1(e) establishes that the Department may not waive the interest imposed under this section. Therefore, the interest may not be waived.

FINDING

Taxpayer's protest is denied.

III. Tax Administration – Negligence Penalty

Taxpayer protests imposition of a ten percent (10%) negligence penalty. Taxpayer states that it makes every attempt to collect, self-assess and remit the proper amount of sales and use taxes due, and has implemented numerous procedures to be in compliance. Taxpayer also believes that it acted in a prudent manner and that the resulting liabilities result from either taxpayer's interpretation of the tax codes or an oversight.

The relevant regulation is 45 IAC 15-11-2(c), which states in part:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-2.1] if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, taxpayer has demonstrated that it exercised ordinary business care and prudence in carrying out its duty to pay sales tax. Therefore, taxpayer has affirmatively established reasonable cause, and the negligence penalty shall be waived.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

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CONSOLIDATED LETTER OF FINDINGS
97-0209, 97-0210, 97-0211, 97-0212, 97-0213, 97-0214 ST
Sales and Use Tax
For the Period: 1992-1995

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Departments official position concerning a specific issue.

ISSUES

I. Sales/Use Tax – Software Licensing and Maintenance Agreements

Authority: IC 6-2.5-2-1; IC 6-2.5-3-2; 45 IAC 2.2-4-2; *Information Bulletin #8, Sales Tax* (February 1990); *Information Bulletin #2 Sales Tax* (August 1991)

Taxpayer protests the imposition of use tax on its software licensing agreements.

II. Sales and Use Tax – Promotional Materials

Authority: IC 6-2.5-3-1; IC 6-2.5-3-2; IC 6-2.5-5-36; *Miles, Inc. v. Indiana Department of State Revenue*, 659 N.E.2d 1158 (Ind.Tax 1995); *USAir, Inc. v. Indiana Department of State Revenue,* 623 N.E.2d 466 (Ind.Tax 1993)

Taxpayer protests the imposition of use tax on promotional materials.

III. Sales and Use Tax – Boilers and Related Equipment

Authority: 45 IAC 15-3-2; *Commissioner's Directive # 3* (April 15, 1986)

Taxpayer protests the imposition of use tax on its certified resource recovery system.

IV. Sales and Use Tax – Lump Sum Contracts

Authority: IC 6-2.5-8-8; 45 IAC 2.2-3-8; 45 IAC 2.2-3-9

Taxpayer protests assessments of use tax on construction items used by contractors in completing lump sum contracts.

V. Sales and Use Tax – Service and Maintenance Agreements

Authority: None

Taxpayer has provided the Department with Agreements that Audit has not reviewed.

VI. Sales and Use Tax – Energy Center

Authority: IC 6-2.5-4-5; IC 6-2.5-5-5.1

Taxpayer protests assessment of use tax on payments received for the provision of energy.

VII. Sales and Use Tax – Storage and Transportation of Work-in-Process

Authority: IC 6-2.5-5-3; 45 IAC 2.2-5-8; *General Motors v. Dept. of State Revenue*, 578 N.E.2d 399 (Ind.Tax 1991)

Taxpayer protests the denial of industrial exemptions for equipment and supplies used in the storage and transportation of "work-in-process."

VIII. Sales and Use Tax – "Production" Equipment

Authority: IC 6-2.5-3-2; IC 6-2.5-5-3; IC 6-2.5-5-5.1; 45 IAC 2.2-5-8

Taxpayer protests the imposition of use tax on "production" equipment.

IX. Sales and Use Tax - "Sharpening" Tools and Equipment

Authority: IC 6-2.5-5-3; IC 6-2.5-5-5.1; *Rotation Products Corp. v. Indiana Dept. of State Revenue,* 690 N.E.2d 795 (Ind.Tax 1998)

Taxpayer protests the imposition of use tax on tools and equipment.

X. Sales and Use Tax - Safety Equipment

Authority: IC 6-2.5-5-3; 45 IAC 2.2-5-8

Taxpayer protests the imposition of use tax on its purchases of "safety equipment."

XI. Tax Administration - Penalty

Authority: IC 6-8.1-10-2.1; 45 IAC 15-11-2

Taxpayer protests imposition of the ten percent (10%) negligence penalty.

STATEMENT OF FACTS

Taxpayer (the Parent Corporation and its five (5) Subsidiaries) manufactures and markets a variety of consumer products. As a result of Sales/Use tax audits for the period July 1, 1992 through June 30, 1995 *(separate audits were conducted for each entity*), proposed assessments were made against Taxpayer. These assessments are now under protest.

The Parent has requested these six (6) protests be consolidated for purposes of hearing and resolution. The Department, when appropriate, may refer to any member(s) of the consolidated group as "Taxpayer." Additionally, "Parent," "Subsidiary," and "Affiliate" will also be used to refer to members of the consolidated group.

I. Sales/Use Tax – Software Licensing and Maintenance Agreements

DISCUSSION

Taxpayer entered into software licensing and maintenance agreements with two software developers/vendors ("**Vendor A**" and "**Vendor O**"). The agreements covered both the use and maintenance of Vendor software. As Taxpayer failed to pay sales tax at the time of acquisition, Audit assessed use tax on these licensing and maintenance agreements. Taxpayer argues the assessments are invalid as Audit is attempting to impose sales/use taxes on "customized" software—a position contrary to Department policy.

Licensing Agreements

Taxpayer entered into a licensing agreement with Vendor A. Taxpayer contends Vendor A's licensed software represents exempt "customized" programming. Taxpayer explains:

> This software developed by [Vendor A] was: (i) designed specifically for [Taxpayer]; (ii) was not developed for sale or lease on the general market; and (iii) was not sold or leased on the general market. In fact, this software, because it was customized to meet [Taxpayer's] unique needs, was not used by any prior [Vendor A] customer. The extent of the time and effort required to design custom software for a company the size of [Taxpayer] is dramatically evidenced by [Vendor A's] investment in this project. [Vendor A's] employees spent over a year designing and installing this software for [Taxpayer]. After installation, [Vendor A's] employees continued to work on the software because it did not conform to [Taxpayer's] specifications.

Taxpayer also licensed two types of programs from Vendor O—**Full Use Programs** and **Deployment Programs**. Taxpayer and Audit both agree the Full Use Programs represent taxable "canned" software.

Taxpayer asserts, however, that the Deployment Programs were "[d]esigned developed, and customized to meet [Taxpayer's] unique and specific needs and were not previously usable, or used, by any other clients [of Vendor O]." As such, these programs represent exempt "customized" software.

Audit based its assessment on IC 6-2.5-3-2, which provides for the imposition of use tax on the "[s]torage, use, or consumption of tangible personal property in Indiana, if the property was acquired in a retail transaction…"—unless, of course, an exemption applies. Furthermore (and more germane to the taxation of computer software), the Department's *Information Bulletin #8*, *Sales Tax* (February 1990), states in part:

> As a general rule, transactions involving computer software are not subject to Indiana Sales or Use Tax provided the software is in the form of a custom program *specifically designed* for the purchaser….Pre-written programs, not specifically designed for one purchaser, developed by the seller for sale or lease on the general market…are subject to tax *irrespective of the fact that the program may require some modification for a purchaser's particular computer* (emphasis added).

Audit determined Vendor A's software and Vendor O's Deployment programs had been "developed…for sale or lease on the general market," and therefore, were subject to tax. Audit maintains all software modifications occurred *after* the software had been acquired by Taxpayer. Consequently, Audit proposed assessments of use tax on the licensing of the software, but not on any of the subsequently provided programming services.

The site license Taxpayer purchased from Vendor A was for a flexible, comprehensive, component-based business application software package. According to the licensing agreement, Vendor A included the following business application modules in Taxpayer's software package:

- ➢ Inventory Management System
- ➢ Manufacturing Standards Data Base
- ➢ Purchasing
- ➢ Material Requirements Planning
- ➢ Master Schedule
- ➢ Shop Floor Control
- ➢ Capacity Requirements Planning
- ➢ Configurator
- ➢ General Ledger
- ➢ Accounts Receivable
- ➢ Accounts Payable
- ➢ Order Entry and Invoicing
- ➢ SQR

Vendor A's software was designed to operate in a specific software environment (i.e., a specific relational data base management system), which Taxpayer licensed from Vendor O.

On July 30, 1993, Taxpayer and Vendor A entered into a "Standard License and Maintenance Agreement." Paragraph 4.1 of the agreement cautioned:

> Unless a separate written Custom Programming and Services Agreement has been signed by the parties, the parties do not contemplate that [Vendor A] will undertake to create any modifications to the Licensed Program for use by Licensee [i.e., Taxpayer]. If the parties have executed a Custom Programming and Services Agreement, then the creation and use of modifications to the Licensed Program shall be governed by the terms of such agreement.

Concomitant with execution of the "Standard License and Maintenance Agreement," Taxpayer and Vendor A entered into a "Custom Programming and Services Agreement" (CPSA). The CPSA represented a contract between Taxpayer and Vendor A for future programming and design services—services to be provided by Vendor A and billed at the daily rate of $1,080.00.

The nature of the licensed software, as well as the terms of the agreements, strongly suggests Taxpayer licensed a *standard* business application software package—i.e., the "Original [Vendor A] Application Software." But to modify this "original" software, Taxpayer and Vendor A entered into another agreement, the CPSA, to create "Modified [Vendor A] Application Software" as well as "Hybrid Work." Audit's proposed assessments apply only to the "original software," and not to any subsequently provided programming and design services.

The Department believes that Vendor A's software represents "canned," pre-written business application software which is available to all—even though the software was subsequently "modified" to meet Taxpayer's specific needs. But even "modified," in this context, is not synonymous with "customized." Software can be "modified" in many ways - ranging from the selection of setup, installation, and configuration options to the "writing" and "rewriting" (regardless of methodology used) of source code. Only the latter (i.e., "writing" and "rewriting" source code) represents the creation of "custom" software.

Custom software (or programming) represents a professional service rendered pursuant to 45 IAC 2.2-4-2. (Also see *Information Bulletin #8, Sales Tax.*) Modifications and additions to the original source code - changes made specifically for Taxpayer - represent custom programming services; and as such, are not taxable. However, any "modification" or "customization" performed on software **after its purchase** will not transform taxable, "canned" software into exempt, "customized" software. The Department finds Taxpayer's licensing of the "Original [Vendor A] Application Software" to be a taxable transaction.

With regard to Vendor O's Deployment Programs, "Amendment 2 to the Software License and Services Agreement between [Taxpayer] and [Vendor O]" (effective August 27, 1993) contained the following terms:

1.2 LICENSE TYPE

"Full Use Programs" are defined as an unaltered version of the Licensed Programs with all functions intact.

"Deployment Programs" are limited to use solely in conjunction with and in support of internal Client Application(s) ("Client Application(s)") and as restricted below. The combination of the Deployment Programs and a Client Application shall be defined as the Application Package.

a. The Application Package under Client Application control may be used to create new tables or alter tables only to the extent necessary to implement the Application Package's functions. The Application Package may not allow use of the Deployment Programs' Create or Alter commands or any other command that would allow the User to create tables or alter tables outside the scope of those necessary for the operation of the Client Application(s).

b. The Deployment Program's in the Application Package may be used by Users of the Deployment Programs for query and data entry only.

c. The Deployment Programs shall not be used outside the scope of the Application Package(s).

The chosen terminology describes limited use software which collectively operate as an interface between Taxpayer's existing application programs and Vendor O's Full Use Programs. Such utility and context suggest attributes of "custom" software. The Department concludes, therefore, the licensing of Vendor O's Deployment Programs does not represent a taxable transaction.

Maintenance Agreements

Taxpayer purchased optional software maintenance agreements from **Vendor A** and **Vendor O**. Taxpayer did not pay any sales tax or self-assess use tax on these transactions. Audit, therefore, proposed assessments of use tax on Taxpayer's purchases.

Optional warranties and maintenance agreements, generally, are not subject to Indiana sales tax. "However, if the [optional warranty or maintenance] agreement includes a charge for property to be periodically supplied, the agreement would be subject to tax." In the context of optional software maintenance agreements, the distribution of program updates represents "property to be periodically supplied." *Information Bulletin #2, Sales Tax* (August 1991).

Taxpayer's maintenance agreements with **Vendor A**—"Standard License and Maintenance Agreement" and the "Custom Programming and Services Agreement"—contain similar language. The "Standard License and Maintenance Agreement" reads, in part:

> This Maintenance Agreement, and the Annual Maintenance Fee, shall cover routine 'bug fixes', troubleshooting, advice and assistance, *and such modifications enhancements and updates of the Licensed Program as [Vendor A], at its option, may elect to offer its Licensees. The Annual Maintenance Fee* ***shall not entitle Licensee to receive any substantial modifications or updates of the Licensed Program****,* specifically including but not limited to modifications that may be made by (Vendor A) because of changes in the System Hardware, Operating System Software, or the (Vendor O) Environment (emphasis added).

Taxpayer also entered into a "Software License and Services Agreement" with **Vendor O**. Taxpayer explains:

> [Taxpayer] agreed to pay Vendor O for "**Basic** Technical Support services" pursuant to Section 6.1 of the agreement…. [Vendor O] did not agree to provide software updates pursuant to Section 6.1, and, consistent with the agreement, [Vendor O] did not provide any updates to Taxpayer in exchange for these maintenance service payments.

Since Taxpayer's optional software maintenance agreements with Vendor A and Vendor O do not include the right to receive program updates—or any other tangible personal property—the agreements, consistent with IC 6-2.5-2-1 (imposition of sales tax), IC 6-2.5-3-2 (imposition of use tax), and *Information Bulletin #2, Sales Tax* (August 1991), are not subject to Indiana sales and use taxes.

FINDINGS

Taxpayer's protest is sustained to the extent assessments were made on its licensing of Vendor O's Deployment Programs and its purchase of service and maintenance agreements from Vendors A and O. Taxpayer's protest is denied, however, on assessments based on its licensing of Vendor A's software.

II. Sales and Use Tax – Promotional Materials

DISCUSSION

Audit assessed use tax on the Subsidiaries acquisition of promotional items and advertising materials "purchased" from both in-state and out-of-state vendors. Taxpayer engaged vendors to provide **(1)** design and layout "services" (i.e., camera-ready art) for its advertising literature. Additionally, Taxpayer acquired a variety of **(2)** promotional materials from disparate sources. All materials acquired were transported to Taxpayer's Graphics Distribution Center prior to distribution. Audit explains:

> [Two of the Subsidiaries'] sales divisions purchase various promotional items which are delivered to the…Distribution Center…where they are collated and redistributed to salesmen and dealers in Indiana and across the country. These items include brochures, catalog sheets, price lists, etc., purchased from outside vendors both within and without Indiana. Other promotional materials distributed in the same manner include various, which are primarily purchased from the…[Parent's] manufacturing companies. The promotional items are all distributed free of charge.

Audit estimates approximately 97.5% of Taxpayer's promotional items and advertising materials were shipped out-of-state for use outside Indiana. Audit, therefore, assessed use tax on 2.5% of Taxpayer's purchases of promotional materials from non-Indiana vendors. However, Audit assessed use tax on 100% of Taxpayer's purchases from Indiana vendors. Taxpayer protests 97.5% of these Indiana assessments.

"An excise tax, known as the state gross retail tax [i.e., sales tax] is imposed on retail transactions made in Indiana." IC 6-2.5-2-

1(a). A complementary excise tax, "known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana, if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC 6-2.5-3-2(a). "Storage," as used in IC 6-2.5-3-2(a), **"means the keeping or retention of tangible personal property in Indiana for any purpose except the subsequent use of that property solely outside Indiana….** The complementary formulation exists to ensure non-exempt retail transactions that escape sales tax liability are nonetheless taxed." *USAir, Inc. v. Indiana Department of State Revenue,* 623 N.E.2d 466, 469 (Ind.Tax 1993) (*"USAir II"*).

(1) Camera-ready art

Taxpayer characterized some of its purchases as follows:

[A sales subsidiary of the parent corporation] utilized out-of-state companies to perform design and layout for advertising literature and promotional materials (such as brochures, catalog sheets, and price lists). [The subsidiary] then had "camera ready" art delivered to Indiana printers who performed the printing services. [The subsidiary] owned the art at all times.

Taxpayer contends the acquisition of camera-ready art should be exempt from sales and use taxes because "commercial printing and binding has long been recognized by the Indiana Supreme Court to be a service business, not the sale of property."

IC 6-2.5-5-36 provides for the following exemption:

Transactions involving tangible personal property acquired by a person that has contracted with a commercial printer for printing are exempt from the state gross retail tax, if the property is acquired for use at the commercial printer's premises and the commercial printer could have acquired the property exempt from the state gross retail tax and use tax.

As added by P.L.70-1993, Sec, 3, retroactive to January 1, 1993.

The Department finds that Taxpayer's camera-ready art purchased after December 31, 1992, and subsequently sent to an Indiana commercial printer, is exempt from Indiana sales and use taxes. As for Taxpayer's camera-ready art prepared prior to January 1, 1993, no such exemption exists.

(2) Other promotional materials

Taxpayer acquired, exempt, other promotional items and advertising materials from both Indiana and non-Indiana vendors. As 97.5% of these items were eventually distributed out-of-state, Taxpayer did not self-assess use tax on 97.5% of these purchases. Audit approved this exclusion for out-of-state purchases, but not for Taxpayer's Indiana purchases. Audit proposed assessments on 100% of Taxpayer's Indiana purchases. Taxpayer contends exempt treatment is justified for both Indiana and non-Indiana purchases.

Specifically, Taxpayer argues that pursuant to IC 6-2.5-3-2 (excise tax imposed on the "storage, use, or consumption of tangible personal property"), and IC 6-2.5-3-1(b) ("'[s]torage' means the keeping or retention of tangible personal property for any purpose **except the subsequent use of that property solely outside Indiana**"), 97.5% of its Indiana purchases should also be exempt from use tax (emphasis added).

In this instance, Audit proposed assessments of use tax because Taxpayer failed to pay sales tax on non-exempt Indiana purchases. While the vehicle for the collection of sales tax delinquencies is proposed assessments of use tax, liability derives from Taxpayer's failure to pay a validly imposed sales tax. Taxpayer may not invoke use tax exemptions for purposes of avoiding its sales tax responsibilities. Use tax exemptions were not created to provide amnesty for sales tax transgressions.

FINDING

Taxpayer's protest is partially sustained and partially denied.

III. Sales and Use Tax – Boilers and Related Equipment

DISCUSSION

Audit proposed assessments of use tax on a percentage of Taxpayer's boiler equipment, repair parts, boiler chemicals, and other consumables associated with the operation of several boilers purchased during the audit period.

Taxpayer contends the assessments are invalid as they contravene conclusions reached by the Department in prior letters of findings issued to Taxpayer and conflict with findings reached in prior litigation.

Taxpayer explains:

[Taxpayer's…] collection system, certain boilers and [Taxpayer's] energy center were certified as a resource recovery system [by the Indiana Department of Environmental Management]. This system is also part of the manufacturing process. The dust collection system, which includes bins, was considered to be part of the manufacturing process in the previous letter of findings issued to [Taxpayer] and in [the findings of an Indiana court in a case in which Taxpayer participated as Appellee-Plaintiff].

Audit, familiar with Taxpayer's argument, responds:

The [T]axpayer feels the … boilers are 100% exempt due to being certified as a Resource Recovery System for property tax purposes. … The current Department policy does not allow an exemption for boiler equipment due to [the equipment] being certified as a Resource Recovery System. This is consistent with the first Letter of Findings on the last audit, which stated the predominate purpose for using the … boilers is cost savings, not for environmental concerns or requirements. There is no existing exemption under Indiana Sales Tax Law relating to Resource Recovery Systems.

Previously, the Department has allowed Taxpayer an exemption for IDEM certified resource recovery systems. However, in a letter of finding ("LOF") dated March 23, 1992, the Department denied Taxpayer a sales/use tax exemption for these resource recovery systems. This denial was "overturned" by the Department in an "adjustment letter" sent to Taxpayer on October 15, 1992.

To wit:

Boiler related purchases at [Taxpayer's] other manufacturing facilities are exempt to the extent the boiler and related equipment ha[ve] a timely Resource Recovery Certification.

Letter to Taxpayer, October 15, 1992.

Given the Department's previous correspondence with Taxpayer—and consistent with 45 IAC 15-3-2, and *Commissioner's Directive #3*, revised April 15, 1986—any revocation or modification by the Department of a ruling previously issued to Taxpayer cannot be retroactively applied.

Therefore, to the extent the Department can verify that the Indiana Department of Environmental Management (IDEM) certified Taxpayer's sawdust collection system, certain boilers, and its energy center as resource recovery systems, Taxpayer may claim the exemption.

However, no legal basis exists to support such an exemption for tangible personal property certified by IDEM as a "resource recovery system." For sales/use tax exemption purposes, utility is determinative. The tangible personal property must be used in an exempt manner. (See IC 6-2.5-5-30, exemption for equipment used to comply with "environmental quality statutes, regulations, or standards;" and IC 6-2.5-5-3, machinery tools and equipment directly used "in the direct production…of other tangible personal property.")

Consequently, Taxpayer may no longer rely on any previous rulings to the contrary, which are hereby revoked.

FINDING

Taxpayer protest is sustained.

IV. Sales and Use Tax – Lump Sum Contracts

DISCUSSION

Audit assessed use tax on tangible personal property purchased by Taxpayer. The property was subsequently incorporated into real property. As justification for the imposition of use tax, Audit cites 45 IAC 2.2-3-8(a), which states in part:

The conversion of tangible personal property into realty does not relieve the taxpayer from a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property.

Audit described Taxpayer's taxable transactions in the following manner:

The taxpayer contracted with local contractors to perform lump sum improvements to realty concerning building expansions & improvements, including a retrofit of the overhead plant lighting….**On some of these contracts, the contractor had an exemption certificate on file and exempted all of the construction materials on these jobs.** The contractors have submitted material cost breakdowns to the taxpayer for the jobs in question (emphasis added).

Generally speaking, with regard to "lump sum" contracts, the contractor is recognized as the "end user" of the materials and therefore, is liable for any sales and use taxes owed on the purchased materials.

Regulation 45 IAC 2.2-3-9(e)(3) explains this taxing regime:

(e) Disposition subject to use tax. With respect to construction materials a contractor acquired tax-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when he disposes of such property in the following manner:

(3) Lump sum contract. He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price.

The regulatory language, on its face, appears to support Taxpayer's protest. However, an exemption is provided for the taxable disposition discussed in 45 IAC 2.2-3-9(e)(3); the exemption, though, is qualified by the following language:

A disposition under C. [*subsection (e)(3) of this section]* [i.e., "Lump sum contract"] will be exempt from the use tax only if the contractor received a valid exemption certificate, not a direct pay permit, from the ultimate purchaser or recipient of the construction material (as converted), provided such person could have initially purchased such property exempt for the state gross retail tax.

45 IAC 2.2-3-9(f).

Taxpayer, the "ultimate purchaser or recipient," provided its contractors with exemption certificates. IC 6-2.5-8-8. The contractors, therefore, did not self-assess use tax on the construction materials that it purchased. Audit subsequently discovered the exemption certificates had not been properly issued, as Taxpayer was not a "person [that] could have initially purchased such property exempt for the state gross retail tax." Consequently, liability for use tax lies with Taxpayer, and not its contractors.

FINDING

Taxpayer's protest is denied.

V. Sales and Use Tax – Service and Maintenance Agreements

DISCUSSION

As part of its protest, Taxpayer submitted seven (7) service and maintenance agreements ("Agreements") for the Department to review. Taxpayer explains:

The following items were not received by the Indiana Auditors during the audit. Copies of the agreements are attached.

Taxpayer's brief—"Issue V: Maintenance Agreements."

After reviewing Taxpayer's submissions and Audit narratives, it is not clear to the Department whether Taxpayer is protesting proposed Audit assessments, or Taxpayer is requesting a refund for sales and use taxes paid in error. Regardless of characterization, Taxpayer "prays" for favorable Audit adjustments.

The Department will forward copies of the Agreements to the Audit Division for further review. Any verified overpayments will be offset to the extent outstanding proposed assessments exist.

FINDING

Taxpayer's protest is sustained to the extent the Department agrees to accept copies of these Agreements for further Audit review.

VI. Sales and Use Tax – Energy Center

DISCUSSION

The Parent corporation operates an "energy center"—a certified resource recovery system—that creates energy for both the Parent and two (2) of its Subsidiaries. The Subsidiaries reimburse their Parent for the operational costs of the center on an allocated cost basis (monthly usage plus a fixed overhead charge). Sales tax was not paid on these energy purchases. Rather, the Subsidiaries self-assessed use tax based on the percentage of nonexempt usage. Audit proposed additional assessments to the extent the energy was not used in production and sales tax had not been paid or use tax self-assessed and remitted to the Department. (See IC 6-2.5-5-5.1.)

Taxpayer offers three (3) arguments in response to Audit's assessments. **First**, even assuming Taxpayer is "selling" energy to its Subsidiaries, Taxpayer contends it is not required to collect sales tax in the absence of a levying statute. Taxpayer directs the Department's attention to IC 6-2.5-4-5 (b) which imposes sales tax on sales of energy by "power subsidiar[ies]" and "person[s] engaged as a public utility." Taxpayer reasons that as a manufacturer, it cannot be classified as a "power subsidiary" or "public utility;" therefore, its "energy sales" cannot be subject to the levying provisions of IC 6-2.5-4-5. Taxpayer notes that no other statute authorizes the collection of sales tax on transactions involving the sale of energy.

Second, Taxpayer introduces *Indiana Dept of Revenue v. Cable Brazil, Inc.*, (1978) 177 Ind.App. 450, 380 N.E.2d 555, (*electrical signal used in furnishing cable television was not tangible personal property*) for the proposition that "energy sources" are not tangible personal property. Accordingly, IC 6-2.5-2-1, which imposes the state gross retail tax on "retail transactions" (i.e., the acquisition of tangible personal property for the purpose of resale and the subsequent transfer of that property to another for consideration, IC 6-2.5-4-1), cannot apply. Similarly, IC 6-2.5-3-2, which imposes use tax on the storage, use, or consumption of tangible personal property if acquired in a retail transaction, cannot apply.

And **third,** Taxpayer argues that even if "energy sources" represented tangible personal property, its transfer, at least in this instance, cannot be attributed to a "retail transaction." Taxpayer explains:

> [The Parent] was not "selling at retail." [The Parent] did not "acquire" tangible personal property for the purpose of retail. Rather, [the Parent] created the energy, as the Department acknowledges in this audit and in the prior letter of findings. Furthermore, [the Parent] did not "sell" the energy, as the Department previously acknowledged as well. [Taxpayer] operate[s] a "unitary" business as the Department has accepted for income tax purposes. [The Parent] was not regularly engaged in the sale of the energy in the retail market. It did not offer the energy for sale to the general public at all. To the contrary, it simply generated energy for "its own energy needs."

The Department needs only to ascertain whether the Parent represents a "person engaged as a public utility" within the meaning of IC 6-2.5-4-5 in order to determine the validity of these assessments.

The language of IC 6-2.5-4-5 reads, in part:

> (b) A power subsidiary or **a person engaged as a public utility** is a retail merchant making retail transaction when the subsidiary or person furnishes or sells electrical energy, natural gas, artificial gas, water, steam, or steam heating service to a person for commercial or domestic consumption.
>
> (c) Notwithstanding subsection (b), a power subsidiary **or a person engaged as a public utility** is not a retail merchant making a retail transaction when:
>
> > (3) the power subsidiary or person sells the services or commodities listed in subsection (b) to a person for use in manufacturing, mining, production…. However, this exclusion for sales of the services and commodities only applies if the services are consumed as an essential and integral part of an integrated process that produces tangible personal property and those sales are separately metered for the excepted uses listed in this subdivision, **or if those sales are not separately metered by are predominately used by the purchaser for the excepted uses listed in this subdivision** (emphasis added).

The statute uses the phrase "a person engaged as a public utility" rather than "public utility." The choice of words suggests the statutory language is directed towards "persons" other than "power subsidiaries" and "public utilities." The Department has interpreted this phrase to include all "persons" who are providing services traditionally provided by public utilities. Consequently, for purposes of IC 6-2.5-4-5, a "person engaged as a public utility" is any person providing utility services—without reference to the "person's" business association. The Parent meets this definition.

As a "person engaged as a public utility," the Parent should have collected sales tax on it sales of energy to its two (2) Subsidiaries. However, as each Subsidiary predominantly used the purchased energy for exempted manufacturing activities (85% and 87.6%), each Subsidiary qualifies for the "predominant use " exclusion provided by IC 6-2.5-4-5(c)(3).

FINDING

Taxpayer's protest is sustained.

VII. Sales and Use Tax – Storage and Transportation of Work-in-Process

DISCUSSION

Audit assessed use tax on storage and transportation supplies, and equipment (e.g., pallets, forklift trucks, etc.), which were purchased by either the Parent or its Subsidiaries. Audit denied the Parent and its Subsidiaries use of any of the manufacturing exemptions for these items because, in Audit's opinion, they were used outside of the purchaser's integrated production process.

In support of its findings, Audit cites 45 IAC 2.2-5-8(f)(3) and (4), which states:

(3) Transportation equipment used to transport work-in-progress or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process.

(4) Transportation equipment used to transport work-in-progress, semi-finished, or finished goods between plants is taxable, if the plants are not part of the same integrated production process.

The Parent and its Subsidiaries file a consolidated return for state income tax purposes. The Parent and its Subsidiaries often transfer work between each other's facilities. Taxpayer has characterized all work transferred between members of its unitary group as "work-in-process." Taxpayer argues that all its transportation equipment used to transfer this "work-in-process" to-and-from members of its unitary group—as well as storage equipment used to "hold" the "work-in-process"—should qualify for manufacturing exemptions.

In support of its position, Taxpayer cites *General Motors v. Dept. of State Revenue*, 578 N.E.2d 399 (Ind.Tax 1991); aff'd 599 2d N.E.588 (Ind. 1992). The *General Motors* court held that packaging materials used to protect parts during delivery from one plant to another were exempt from the gross retail tax. *Id*. at 405. The court's analysis focused on identifying the beginning and end of General Motors' (GM's) integrated production process. The court explained:

> [P]ackaging materials used to transport work in progress parts from GM's component plants to GM's assembly plants would be exempt as an essential and integral part of GM's integrated production process of manufacturing finished automobiles….
>
> [A] determination that an integrated production process ends upon the completion of the actual end product marketed (the *most marketable product*) is wholly consistent with the legislative purposes of the exemption statutes to encourage industrial growth and to avoid tax pyramiding. Accordingly, the court finds GM's packing materials, used in its integrated production process to protect unfinished work in progress transported from one production step to another, exempt from sales/use tax under IC 6-2-1-39 (b) (6) and IC 6-2.5-5-3. *Id* at 405.

For GM, the completed automobile represented its most marketable product; consequently, the scope GM's integrated production process incorporated the work performed at GM's final assembly plant Although the automotive component parts manufactured by GM at its various plants may be *a marketable product*, in the context of GM's business ("[t]he facts of the case as well as previous judicial findings indicate GM's production process is by nature highly integrated"), the court characterized the component parts as *unfinished work in process*. *Id.* at 402.

The Parent compares its situation with that of GM and claims that equipment used to store and transport work-in-process from one Subsidiary to another should be exempt. Taxpayer's common law analysis is faulty.

The *General Motors'* decision stands for the proposition (among others) that the scope of a corporation's (GM's) integrated production process *may extend beyond the boundaries of any one plant (component part plant) or division within a corporation*—especially when the corporation's production process is highly integrated. *General Motors*, however, does not stand, as Taxpayer claims, for the proposition that a corporation's integrated production *process may extend beyond a corporation's own boundaries.* The holding in *General Motors* neither requires nor suggests such an interpretation.

What Taxpayer seeks is the sales/use tax equivalent of the income exemptions/exclusions afforded to corporations filing combined or consolidated returns. (See IC 6-2.1-4-6 and 45 IAC 3.1-1-51 and 52.) Such exemptions/exclusions, however, do not exist. The Department concludes, therefore, that a corporation—whether Parent or Subsidiary— cannot include activities performed by other corporate entities—whether Parent or Subsidiary—when defining the scope of its own integrated production process.

FINDING

Taxpayer's protest is denied.

VIII. Sales and Use Tax – "Production" Equipment

Audit assessed use tax, pursuant to IC 6-2.5-3-2 and 45 IAC 2.2-5-8(d), on Taxpayer's purchase of "production" equipment.

(a) Stretch Wrap Machines

Taxpayer purchased two (2) stretch wrap machines—one located near production lines, the other near a shipping area. Taxpayer explains their utility:

> The [stretch wrap] machines are used to wrap plastic around assemblies in trays with a top and a bottom for the … products and used to wrap plastic around boxes stacked on wooden pallets for the computer products. The individual assemblies … are placed in the compartments within the stackable trays. The trays are between top and bottom pieces, but are not secured in any way. The plastic is stretched around the trays including the top & bottom pieces to hold them together.

Taxpayer reasons since packaging is required for the protection of its manufactured products, and application of the plastic wrap is part of the packaging process, the stretch wrap machines represent an "essential and integral part of its integrated production

process."

"[A]n excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction." IC 6-2.5-3-2. However, pursuant to IC 6-2.5-5-3(b), "[t]ransactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for his direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property."

Furthermore, 45 IAC 2.2-5-8(d) states that "[d]irect use in the production process begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required."

While packaging materials and equipment, generally, enjoy exempt status; shipping materials and equipment do not. Taxpayer's products are manufactured and individually packaged before being placed into compartments, on stackable trays, and then "stretch wrapped" in preparation for shipment. Shipping is a post-production activity; any equipment used to facilitate shipping that is not part of Taxpayer's integrated production process is subject to Indiana sales and use taxes.

Consistent with the foregoing analysis, Taxpayer's stretch-wrap machine located in its production area may be exempt if used within Taxpayer's integrated production process—i.e., used for packaging manufactured product. In its narrative, Taxpayer distinguishes between its two stretch-wrap machines by location, but not, however, by function. Therefore, absent additional information, the stretch-wrap machine located in the production area, like the stretch-wrap machine used in shipping, will not qualify for exempt treatment.

(b) Smart Sonic Cleaning Station

Taxpayer purchased a smart sonic cleaning station ("cleaning station"). The cleaning station is used to clean stencils. Taxpayer describes the utility of its stencils and cleaning station:

> Stencils are used to force paste through holes on the stencil onto a board. The placement [of the paste] must be very exact, or the parts won't be placed on the boards correctly. Manually during production, the stencils are wiped off. After every shift or change over, the stencil is washed in the cleaning station. If we [Taxpayer] have a misprinted board during a shift, the stencil is washed off immediately in the cleaning station. The equipment [i.e., the cleaning station] removes [paste] clogged holes from stencils [because] [i]f the holes are clogged, the paste will not be applied to the board correctly which will cause poor quality.

Taxpayer seeks one of the industrial exemptions for its cleaning station as it represents an essential and integral part of its integrated production. (See IC 6-2.5-5-3 and 45 IAC 2.2-5-8.)

The Department believes that while the stencils may be characterized as an essential part of Taxpayer's production process, equipment used to **clean** the stencils cannot. Cleaning activities generally, and the cleaning of Taxpayer's stencils particularly, are properly characterized as pre-production and/or post-production activities. As such, Taxpayer may not claim any of the industrial exemptions for its cleaning system.

(c) Smoke Absorbers

Taxpayer claims an exemption for smoke absorbers used to remove fumes from the air during the cleaning of solder pots. Taxpayer explains:

> When using molten solder in solder pots, a buildup of chemicals occurs which must be cleaned out. Tin lead and other chemicals are removed during cleaning and would be emitted into the air if not for the use of the smoke absorbers. Taxpayer is a smoke free environment by necessity. A smoke-filled plant would contaminate the assemblies and adversely affect production workers in the operation.

Taxpayer contends its smoke absorbers represent exempt production machinery because their use allows Taxpayer's workers to participate in the production process.

Regulation 45 IAC 2.2-5-8(c) Ex.2(F) states:

> (2) The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt.
>
> *******
>
> (F) Safety clothing or equipment which is required to allow a worker to participate in the production process without injury…

The facts presented indicate that while the smoke absorbers are "essential" to Taxpayer's *cleaning* process, they are not part of its *production* process. The cleaning of production equipment is generally not part of an "integrated production process" as cleaning usually represents pre-production and post-production activities. The Department concludes Taxpayer's smoke absorbers are not an "essential and integral part" of Taxpayer's integrated production process. The smoke absorbers, therefore, are taxable.

(d) Ionographs

Taxpayer purchased ionographs. The ionographs, according to Taxpayer, are used for testing and inspection purposes. Taxpayer describes the utility of its ionographs:

The ionograph includes a mixture of dionized water and isopropyl alcohol. Each morning and each afternoon, as a matter of

standard testing of production, one [item] (manufactured by Taxpayer) is placed in the solution. Contaminates such as salt are washed off the [item] and into the water. The ionograph measures the level of contaminates which come from the [item]. If the contaminates are not within the allowed range of contaminates to be present as prescribed by industry standards…the entire morning or afternoon run would have to be redone. This is a sampling method of testing production to assure product quality.

Taxpayer, invoking the language of 45 IAC 2.2-5-8(i), believes that "because of the functional interrelationship between the testing equipment [i.e., the ionographs] and the machinery on the production line and because of the product flow, the testing equipment is an integral part of the integrated production process and is exempt."

Tangible personal property directly used in the direct production of other tangible personal property is exempt from Indiana sales and use tax. IC 6-2.5-5-3. The scope of this "machinery, tools, and equipment" industrial exemption has been interpreted to include certain types of testing and inspection equipment. As Taxpayer acknowledges, 45 IAC 2.2-5-8(i) provides an exemption for "[m]achinery, tools, and equipment *used to test and inspect the product as part of the production process…"* (emphasis added).

The Department agrees with Taxpayer's analysis. Taxpayer does not use its ionographs to test raw materials—a nonexempt pre-production activity. Nor does Taxpayer use it ionographs to test finished products—a nonexempt post-production activity. Rather, the ionographs are used to test production samples taken from work-in-progress. The Department finds Taxpayer's sampling and testing of manufactured products to be part of Taxpayer's integrated production process. The ionographs qualify for the exemption provided by IC 6-2.5-5-3.

(e) Labels

Taxpayer protests assessments of use tax of its purchase of two (2) types of tags. Taxpayer claims an exemption for these tags under IC 6-2.5-5-5.1(b), which exempts tangible personal property from state sales and use taxes "if the person acquiring the property acquires it for his direct consumption as a material to be consumed in the direct production of other tangible personal property…."

Taxpayer explains the utility of each tag:

When [raw material] is purchased…[the buyer] places a plastic tag on the [material]. This number will be used to identify the [material] upon arrival and will be used as a reference number throughout our manufacturing process and inventory….Once [material] has been received, [it] will be cut into sections. Another plastic tag with a different color will be placed on each section of the [material]….[W]e are able to track each [section] according to the number assigned. The number acts as a "part number." At any time after a section of [the material] has been tagged, our system can provide information about that section such as which machine centers the [section] has gone through, how much production was yielded, cost, warehouse location, etc.

Taxpayer's identification labels are used outside of Taxpayer's integrated production process; therefore, the labels and do not qualify for any of the industrial exemptions. While accounting, receiving and inventory tracking may represent activities essential to Taxpayer's business, they are not part of its production process.

FINDING

Taxpayer's protest is denied concerning the exemption status of its **(a)** stretch wrap machines, **(b)** smart sonic cleaning machine, **(c)** smoke absorbers, and **(e)** labels. Taxpayer's protest is sustained with regard to the taxability of the **(d)** ionographs.

IX. Sales and Use Tax – "Sharpening" Tools and Equipment

Taxpayer engages in manufacturing, "remanufacturing," and service activities. Taxpayer manufactures saw blades and various types of manufacturing tools. Taxpayer, as a service provider, sharpens saw blades for customers. Additionally, Taxpayer "remanufactures" (Taxpayer's terminology) untipped saw blades. Only the latter activity has resulted in a protested issue.

Audit assessed use tax on Taxpayer's equipment and materials used in "remanufacturing" (i.e., "retipping") activities. Audit characterized Taxpayer's "retipping" activities as one of service—with the effect of denying Taxpayer exemptions for equipment used and materials consumed in "retipping" activities.

Taxpayer briefly describes its "remanufacturing" (i.e., saw "retipping") activities:

[Taxpayer] remanufactures saw blades owned by customers. When the saw blades are shipped to [Taxpayer], they have no value other than scrap value. In order to remanufacture the blades into tipped saw blades, [Taxpayer] must undertake a complex and substantial process in which [Taxpayer] files, carves and tips, balances, realigns, and calibrates the blades. [Taxpayer] applies carbon tips as well as additional materials of braze and flux to the blades. [Taxpayer] uses computers in this remanufacturing process. An average tip remanufacture adds materials in excess of 10% of the total remanufacturing charge….As a result of [Taxpayer's] remanufacturing, the tipped blades generally are stronger, more durable and functionally better suited to newer applications than the blades as originally manufactured. As a result, the tipped blades generally are better products than the blades as originally manufactured.

Taxpayer argues the materials and equipment used in its "remanufacturing" processes should qualify for the sales and use tax exemptions provided by the equipment exemption (IC 6-2.5-5-3), the consumption exemption (IC 6-2.5-5-5.1), and pursuant to *Rotation Products Corp. v. Indiana Dept. of State Revenue,* 690 N.E.2d 795 (Ind.Tax 1998).

In *Rotation Products*, the Court was asked to determine whether Petitioner was entitled to any of Indiana's industrial exemptions for tangible personal property used and consumed in "remanufacturing" activities. To that end, the Court addressed whether Taxpayer's "remanufacturing" activities constituted "production" of tangible personal property, or represented the provision of services. As prelude to its analysis, the Court offered the following observation:

An evaluation of whether activity labeled remanufacturing actually constitutes production within the meaning of the industrial exemptions is a fact-sensitive inquiry, and there are no bright-line tests.

Id. at 805.

The Court then discussed four factors "germane to this fact-sensitive inquiry." The factors announced were:

1) the work performed must be substantial and complex;

2) the article's value after the work (i.e., "remanufacturing") has been done must be greater than the article's value before the work was commenced;

3) the utility of the "remanufactured" item should compare favorably with that of a newly manufactured item; and

4) the work performed should not have been "contemplated as a normal part of the life cycle of the existing article"

Id. at 805, 806.

After applying this four-factor analysis to Taxpayer's "remanufacturing" activities, the Department agrees with Taxpayer's conclusion. Regardless of the characterization of Taxpayer's activities (e.g., servicing, processing, repairing, rebuilding, refurbishing), the work performed by Taxpayer (i.e., saw "retipping") falls within the range of activities that, pursuant to *Rotation Products*, qualify for industrial exemptions.

FINDING

Taxpayer's protest is sustained.

X. Sales and Use Tax – Safety Equipment

DISCUSSION

Taxpayer purchased **safety cans** and **drum vents** both designed, and subsequently utilized, according to Taxpayer, to prevent explosions in the workplace.

"Transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture…of other tangible personal property. IC 6-2.5-5-3(b). The Department has adopted regulations in which certain classifications of tangible personal property have been deemed to have met this "double direct" ("essential and integral") standard.

Regulation 45 IAC 2.2-5-8(c)(2) states in part:

The following types of equipment constitute essential and integral parts of the integrated production process and are, therefore, exempt….

(F) Safety clothing or equipment which is required to allow a worker to participate in the production process without injury or to prevent contamination of the product during production.

Taxpayer's safety cans are used for storage purposes. Taxpayer's drum vents afford proper ventilation. Such functionality represents non-exempt uses. (see 45 IAC 2.2-5-8(e) and (j).) Additionally, Taxpayer's safety cans and drums vents are too far removed, functionally, from Taxpayer's integrated production process to qualify for the exemption provided by 45 IAC 2.2-5-8(c)(2)(F).

FINDING

Taxpayer's protest is denied.

XI. Tax Administration – Penalty

DISCUSSION

Taxpayer protests the imposition of the ten-percent (10%) penalty. The negligence penalty imposed under IC 6-8.1-10-2.1(e) may be waived by the Department where reasonable cause for the deficiency has been shown by Taxpayer. Specifically:

> The department shall waive the negligence penalty imposed under IC 6-8.1-10-2.1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. 45 IAC 15-11-2(e).

Taxpayer has shown reasonable cause in its interpretation of Indiana sales and use tax law.

FINDING

Taxpayer's protest is sustained.

DEPARTMENT OF STATE REVENUE

04980195.LOF

LETTER OF FINDINGS NUMBER 98-0195
State Gross Retail Taxes
For Years 1992, 1993, and 1994

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales Tax Assessed on the Purchase of Safety Equipment – Sound Abatement and Dust Collection Systems

Authority: IC 6-2.5-2-1; IC 6-2.5-5-1 to 38.2; IC 6-2.5-5-3(b); 45 IAC 2.2-5-8(c); 45 IAC 2.2-5-8(F)

Taxpayer protests the assessment of sales tax on the purchase of equipment, installed at taxpayer's steel production facility, purportedly for the purposes of preventing injuries to its employees and for compliance with relevant OSHA standards.

II. Sales Tax Assessed on the Purchase of In Process Material Handing Equipment for Transport of Work-In Process – Overhead Crane Rails and Crane Rail Clips

Authority: 45 IAC 2.2-5-8(f)(3)

Taxpayer protests the assessment of sales tax on the purchase of materials and supplies used to construct material handling equipment used to transport work-in-progress.

III. Gross Retail and Use Tax on Materials Incorporated Into Realty – Direct Payment Permits Issued to Contractors

Authority: IC 6-2.5-4-1(b); IC 6-2.5-4-1(c)(2); IC 6-2.5-4-9; IC 6-2.5-8-9; IC 6-2.5-8-9(a); 45 IAC 2.2-4-21(a); 45 IAC 2.2-4-22(e); 45 IAC 2.2-4-26(a); 45 IAC 2.2-4-26(b); 45 IAC 2.2-4-26(c); 45 IAC 2.2-8-16(c)

Taxpayer protests the assessment of sales tax on materials incorporated into its real property, acquired through lump sum contracts for which taxpayer issued the contractor, purchasing those materials, a Direct Payment Permit.

IV. Sales Tax Assessed on the Purchase of Ore and Limestone Material Handling Equipment – Constituent Parts of Taxpayer's Ore Bridge; Clam Bucket, Hoists, Motors, Crane, and Vertical Trestles

Authority: IC 6-2.5-5-3; IC 6-2.5-5-3(b); 45 IAC 2.2-5-8; 45 IAC 2.2-5-8(c); 45 IAC 2.2-5-8(f)(1); Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983); Indiana Dept. of Revenue v. Kimball Int'l, 520 N.E.2d 454 (Ind. App. 1988)

Taxpayer protests the assessment of sales tax on the purchase of ore and limestone material handling equipment used at taxpayer's steel production facility.

STATEMENT OF FACTS

Taxpayer is a steel producer operating steel plants throughout the world including a facility located in Indiana. Taxpayer's headquarters is located outside of Indiana.

DISCUSSION

I. Sales Tax Assessed on the Purchase of Safety Equipment – Sound Abatement and Dust Collections Systems

Taxpayer protests the assessment of sales tax on the purchase of equipment, installed at taxpayer's steel production facility, purportedly for the purposes of preventing injuries to its employees and for compliance with OSHA standards.

Indiana imposes a gross retail (sales) tax on retail transactions in Indiana. IC 6-2.5-2-1. The legislature has provided a number of exemptions for the imposition of that tax. *See* IC 6-2.5-5-1 to 38.2. One of the exemptions provided is found under IC 6-2.5-5-3(b).

IC 6-2.5-5-3(b) exempts from sales tax liability those "[t]ransactions involving manufacturing machinery, tools, and equipment" and states that such transactions "are exempt from the state gross retail tax if the person acquiring that property acquires it for *direct*

use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property." (Emphasis added).

The Department has issued regulations interpreting the exemption provisions. In this case, the applicable regulation is found at 45 IAC 2.2-5-8(F). Under that regulation property, exempt under IC 6-2.5-5-3(b), has the requisite "direct use" and is consequently exempt under IC 6-2.5-5-3(b) if it has "an immediate effect on the article being produced" and is an "essential and integral part of an integrated process which produces tangible personal property." 45 IAC 2.2-5-8(c). Specifically, under 45 IAC 2.2-5-8(F), "[s]afety clothing or equipment which is required to allow a worker to participate in the production process without injury" comes within the definition of equipment which is part of the taxpayer's integrated production process and is, therefore, exempt.

Taxpayer argues that its "Ladle Active Dust Collection System" and "Temper and Tandem Mill Enclosures" fall within the exemption provided under 45 IAC 2.2-5-8(F).

Taxpayer asserts that its installation of "Temper and Tandem Mill Enclosures" was required to reduce noise to acceptable levels. Prior to taxpayer's decision to install this equipment, taxpayer conducted noise exposure monitoring to determine the level of noise its individual workers were exposed. The monitoring, conducted in April of 1993, determined that taxpayer's individual workers were routinely exposed to noise levels of between 93 to 99 decibels measured on an "A" weighted scale. Taxpayer Departmental Correspondence, Sept. 15, 1993, Table I, p. 3. Monitoring of different locations within the affected area indicted sound levels of between 86 to 105 decibels. *Id.* at Table II, p. 4. At those levels, OSHA standards, 29 C.F.R. 1910.95, require that workers so affected be enrolled in a hearing conservation program and wear hearing protection. *Id.* at p. 1. Those regulations further "call[] for the implementation of engineering controls in order to reduce employee exposure." *Id.* The noise exposure monitoring led to taxpayer's decision to install sound enclosures at its Flat Rolled Finishing Temper Mill in order to moderate the level of noise produced and to protect the workers involved. Capital Project Request, July 15, 1993. The "Temper and Tandem Mill Enclosures" used to moderate noise levels are located within taxpayer's production process. The temper mill operates after the steel annealing process and immediately prior to the steel galvanizing process.

Taxpayer's "Ladle Active Dust Collection System" is designed to capture the dust emitted at each additive transfer location. Taxpayer conducted air monitoring and sampling to determine the level of dust to which its workers were exposed at its ladle additive system. The results indicated the following: (1) samples collected exceeded the limit for total particulate, (2) samples collected exceeded the limit for airborne metal contaminants, (3) samples collected exceeded the limit for airborne manganese contaminants. Taxpayer Corporation Request for Approval, Oct. 12, 1990, p. 2. In order to achieve compliance with OSHA standard, 29 C.F.R. 1910.1000, bringing worker exposure with the Permissible Exposure Limits, taxpayer elected to install a dust collection system at the four transfer points of its ladle additive system. *Id.* This dust collection system operates within taxpayer's continuous production process because is located midway between the initial steps producing raw iron and the final steps processing finished steel. The system is located adjacent to the basic oxygen furnace and operates to remove and collect dust from the area where alloy materials are batched, weighed, and ultimately discharged into the steel produced in the basic oxygen furnace.

Taxpayer's purchase of sound abatement and dust collection equipment falls within the requirements of IC 6-2.5-5-3(b) and 45 IAC 2.2-5-8(F). Taxpayer's Temper and Tandem Mill Enclosures and Ladle Active Dust Collection System are "equipment which is required to allow a worker to participate in the production process without injury." 45 IAC 2.2-5-8(F).

FINDING

Taxpayer's protest is sustained.

DISCUSSION

II. Sales Tax Assessed on the Purchase of In Process Material Handing Equipment – Overhead Crane Rails and Crane Rail Clips

Taxpayer protests the assessment of sales tax on the purchase of equipment and supplies used to construct material handling equipment. Specifically, the equipment and supplies in question, crane rails and rail clips, are part of a tracked, overhead gantry-like device. The device is used to transport ladle buckets, containing molten steel, from taxpayer's basic oxygen furnace to the continuous caster where steel slabs are produced.

45 IAC 2.2-5-8(f)(3) provides that "[t]ransportation equipment used to transport work-in-process or semi-finished materials to or from storage is not subject to [sales] tax if the transportation is within the production process."

The molten steel fits the description of "work-in-process or semi-finished materials." The molten steel results from taxpayer's blast furnace acting upon raw materials to produce molten iron. The molten iron is transported to the basic oxygen furnace which then acts upon the molten iron to produce steel. It is at this point that the equipment at issue is used to transport the molten steel to the continuous caster. The continuous caster then acts upon the molten steel to produce slab steel.

Because this equipment is used to transport work-in-progress within taxpayer's continuous steel production process, the equipment is not subject to sales tax.

FINDING

Taxpayer's protest is sustained.

DISCUSSION

III. Gross Retail and Use Tax on Materials Incorporated Into Realty – Direct Payment Permit Issued to Contractors

Taxpayer protests the assessment of sales tax on materials incorporated into its real property.

During the period of time covered by the audit report, taxpayer issued purchase orders for lump sum improvements to taxpayer's realty which stated that its tax status was that of a taxpayer holding a Direct Pay Permit. In some cases, taxpayer wrote on the purchase order:

Contractor is responsible to pay any state sales or use taxes on items consumed by the contractor and any building materials incorporated into real property or improvements to land. Certain structures may not be considered real property and the sales tax exemption should be requested from Taxpayer.

Additionally, during taxpayer's pre-bid meetings with contractors, held to review and clarify contract terms and conditions, taxpayer purportedly emphasized the contractors' ultimate responsibility for state taxes. The contracts between taxpayer and its contractors typically contained a provision instructing the contractor to include all Indiana sales and use taxes in the lump sum contract price. That provision stated that taxpayer was "exempt from tax" because tax was included in the contract price.

Accordingly, taxpayer maintains that it is not now responsible for gross retail or use tax on materials incorporated into its real property and that there is no law, rule, or case law passing that tax liability onto the taxpayer if the contractor does not recognize his legal sales or use tax liability.

Taxpayer's use of its Direct Payment Permit, issuance of lump sum contracts, and practice of representing to its contractors that it is "tax free" have intertwined a number of issues each of which will be addressed separately.

Taxpayer is not subject to use tax liability for those transactions for which taxpayer either issued a purchase order or contracted for an improvement to taxpayer's realty on the basis of lump sum contracts. Under 45 IAC 2.2-4-22(e), "With respect to construction material a contractor acquired-free, the contractor is liable for the use tax and must remit such tax (measured on the purchase price) to the Department of Revenue when he disposes of such property in the following manner: (1) He converts material into realty on land he owns and then sells the improved real estate; (2) He utilizes the construction material for his own benefit; or (3) Lump sum contract. *He converts the construction material into realty on land he does not own pursuant to a contract that includes all elements of cost in the total contract price."* (Emphasis added). In the lump sum contracts between taxpayer and its contractors, it is the contractor who is ultimately responsible for paying the tax to its own supplier. 45 IAC 2.2-4-26(a) provides that "[a] person (the contractor) making a contract for the improvement to real estate whereby the material becoming a part of the improvement and the labor are quoted as one price is liable for the payment of sales tax on the purchase price of all material so used."

Therefore, for those lump sum contracts, involving improvement to its realty, in which the cost of material and the labor were stated as one price, it is the contractor and not taxpayer who retains responsibility for the payment of sales tax. Further, under 45 IAC 2.2-4-26(b), "the fact that seller (contractor) subsequently furnished information regarding the charges for labor and material used under a flat bid quotation shall not be considered to constitute separate transactions for labor and material."

Conversely, for those transactions in which taxpayer contracted for or received a statement in which the cost of materials and labor was stated separately, taxpayer retains responsibility for sales tax liability on the cost of the materials transferred. Taxpayer has, in effect, engaged in a retail transaction with its contractor. IC 6-2.5-4-1(b). The fact that the material was "transferred alone in or in conjunction with other property or services," IC 6-2.5-4-1(c)(2), is irrelevant. Under 45 IAC 2.2-4-21(a), "[t]he conversion of tangible personal property into realty does not relieve a liability for any owing and unpaid state gross retail tax or use tax with respect to such tangible personal property." An exception is provided under 45 IAC 2.2-4-26(c) for tangible personal property, purchased to become part of an improvement to real estate, when the organization is entitled to an exemption. However, taxpayer's bare assertion that it is "tax free" does not constitute such an exemption. Neither does taxpayer's holding of a Direct Payment Permit constitute an exemption. 45 IAC 2.2-8-16(c) clearly states that "[a] direct payment permit is not a declaration that the issuer is entitled to [an] exemption, but rather is a declaration that the issuer will remit use tax on any purchase on which sales tax is due."

Therefore, under the conditions whereby taxpayer originally obtained its Direct Pay Permit, taxpayer is responsible to the Department for use tax on the material portion of contracts for improvements to its realty, in which the cost of labor and material were separately stated. That responsibility is not alleviated by any agreements or understandings between taxpayer and its contractors regarding the allocation of tax liabilities. Although those agreements and understandings are of some interest to the parties involved, they are not dispositive of the sales and use tax liability taxpayer acquired under IC 6-2.5-4-9.

Taxpayer is reminded of the conditions under which it has been issued the Direct Payment Permit and the purpose for which that permit is intended. The Direct Payment Permit is not a declaration that a taxpayer is entitled to a tax exemption. Instead, it is an agreement between the taxpayer and the Department that the taxpayer will "pay the tax... directly to the department." IC 6-2.5-8-9. The Direct Payment Permit merely allows the taxpayer the option of determining the taxability of the purchased items at a later time. If those items are then determined to be taxable, the taxpayer must remit the use tax. Taxpayer's Direct Pay Permit was issued and remains subject to those conditions the Department deems reasonable. IC 6-2.5-8-9(a). Among those conditions include the stipulation that "[d]irect payment permits do not certify that the issuer is entitled to an exemption and *may not be issued to flat bid (lump sum) contractors."* Ind. Dept. of Revenue Application for Direct Pay Authorization (Emphasis added). If the contractor with whom taxpayer is dealing does not provide a separate breakdown of the costs of materials, "the Direct Payment Permit cannot be used for the lump sum contract." Sales Tax Division Information Bulletin #38.

FINDING

Taxpayer's protest is denied in part and sustained in part.

DISCUSSION

IV. Sales Tax Assessed on the Purchase of Ore and Limestone Material Handling Equipment – Constituent Parts of Taxpayer's Ore Bridge; Clam Bucket, Hoists, Motors, Crane, and Vertical Trestles

Taxpayer protests the assessment of sales tax on its purchase of equipment and supplies incorporated into taxpayer's ore bridge. The ore bridge, an overhead trestle construction upon which a movable clam bucket operates, is located at taxpayer's steel plant and is used to transport iron ore pellets and limestone. These iron ore pellets and limestone are purchased from third-party suppliers and delivered to taxpayer's steel production facility by boat. Upon delivery, these raw materials are off-loaded and then transferred by the ore bridge clam bucket to and temporarily stored in a marshalling yard. As needed, the iron ore pellets and limestone are brought to the blast furnace. A clam bucket (referred to as "grab bucket" in the audit report), motors, hoists, vertical trestles, and ore bridge crane move the ore pellets and limestone from the ore yard to a transfer car for melting in the blast furnace. Taxpayer asserts that it is at this point that the raw materials are "committed to the iron making process and not returned."

Taxpayer bases its protest on IC 6-2.5-5-3. IC 6-2.5-5-3(b) provides an exemption from sales tax for "manufacturing machinery, tools and equipment... if the person acquiring that property acquires it for his direct use in the direct production (or) manufacture... of other tangible personal property." To qualify for exemption from sales and use tax, machinery and equipment must be directly used in the production process. Further, the equipment must have an immediate effect on the article being produced. "Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property." 45 IAC 2.2-5-8(c).

Taxpayer asserts that the clam bucket, hoists, motors, vertical trestle, and ore bridge crane are directly used in and are an integral part of the production of steel. In support of that argument taxpayer compares its own material handling equipment to the stone quarry transportation equipment at issue in Indiana Dept. of State Revenue v. Cave Stone, Inc., 457 N.E.2d 520 (Ind. 1983). In that case, the court held that transportation equipment used in taxpayer's aggregate stone production process was exempt from sales tax because the equipment was essential to achieving the transformation of crude stone into aggregate stone. The court held that the equipment played an integral part in the ongoing process of transformation of the final product. In arriving at that decision, the Cave Stone court held that the focus of analysis should be whether the equipment was an integral part of manufacturing and operated directly on the product during production. *Id.* at 525.

In applying any tax exemption, including the exemption found within 45 IAC 2.2-5-8(c), the general rule is that "tax exemptions are strictly construed in favor of taxation and against the taxpayer." Indiana Department of Revenue v. Kimball Int'l, 520 N.E.2d 454, 456 (Ind. App. 1988).

In addressing the issue raised by taxpayer, example 10, found at 45 IAC 2.2-5-8 is instructive because the situation described is closely analogous to taxpayer's. "A crane is used to unload a barge delivering raw materials to a steel plant where the raw materials are stockpiled in a storage yard adjacent to the plant. The crane is taxable."

The question of the taxability of taxpayer's ore bridge equipment is also directly addressed in 45 IAC 2.2-5-8(f)(1) which states that transportation equipment "used for moving raw materials to the plant prior to their entrance into the production process is taxable."

Taxpayer is correct in citing Cave Stone for the proposition that the "double direct" standard is met when the item used or consumed is an essential and integral part of an integrated production process. Cave Stone, 457 N.E.2d at 524. However, taxpayer's ore bridge equipment is not part of the integrated process producing steel at taxpayer's mill. At taxpayer's steel mill, the ore bridge equipment is used to transport off-loaded raw materials to the marshalling yard and then from the marshalling yard to the blast furnace. The ore bridge equipment is not equipment which has an immediate effect on the steel being produced. It is, instead, a separate unit of machinery both distinct and removed from the actual production of steel. The ore bridge equipment simply functions to transport raw material from one place to another at a point outside the actual steel production process. The limestone and ore pellets are not changed during the time they are being transported by the ore bridge equipment. During the time the ore bridge equipment is acting upon them, the materials are not mixed, altered, combined, or changed in form. As such, the equipment is not integral to the production of steel.

Taxpayer's reference to Cave Stone is inapposite. In that case, the court held that the transportation equipment at issue played an integral part in the production of aggregate stone because the production of taxpayer's product began at the time of "initial stripping, drilling, and blasting at the quarry and end[ed] at the time the stone [was] stockpiled." Cave Stone, 457 N.E.2d at 524. The court found that the transportation equipment moved the unfinished stone in a continuous flow *from one production step to another* with the equipment playing an integral part in the *ongoing process of transformation*. *Id.* at 524-25 (Emphasis added).

FINDING

Taxpayer's protest is respectfully denied.

DEPARTMENT OF STATE REVENUE

04980272.LOF

LETTER OF FINDINGS NUMBER: 98-0272
Individual Income Tax
For Tax Periods 1994-1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of

publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales Tax – Exemption Certificates/Resale Certificates

Authority: IC 6-2.5-5-4; IC 6-5-8-8; 45 IAC 2.2-8-12

Taxpayer protests assessment of sales tax on items sold in which the purchaser provided exemption or resale certificates.

II. Tax Administration – Projection Method

Authority: IC 6-8.1-5-1

Taxpayer protests the test period selected by the auditor.

III. Tax Administration – Penalty and Interest

Authority: IC 6-8.1-10-1

Taxpayer protests imposition of penalty and interest.

STATEMENT OF FACTS

Taxpayer sells industrial parts, tools and supplies. The product line ranges from general housekeeping items to general maintenance supplies to repair and maintenance parts for manufacturing equipment. A separate division sells industrial metals. The Indiana Department of Revenue ("Department") conducted a Sales tax audit for the years of 1994-96, and issued assessments on items on which no Indiana sales tax had been collected or remitted. Taxpayer protests the assessments.

I. Sales Tax – Exemption Certificates/Resale Certificates

DISCUSSION

Taxpayer protests the assessment of sales tax on items it believes are exempt as they are sold either to not-for-profit organizations or to manufacturers to be incorporated into other products or directly used in the manufacturing process. Taxpayer refers to IC 6-2.5-5-4, which states:

> Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for his direct use in the direct production of the machinery, tools, or equipment described in section 2 or 3 of this chapter.

Taxpayer believes that its acceptance of resale certificates or exemption certificates meets the "good faith" criteria described by IC 6-2.5-8-8(a), which states:

> A person, authorized under subsection (b), who makes a purchase in a transaction which is exempt from the state gross retail and use taxes, may issue an exemption certificate to the seller instead of paying the tax. The person shall issue the certificate on forms and in the manner prescribed by the department. A seller accepting a proper exemption certificate under this section has no duty to collect or remit the state gross retail or use tax on that purchase.

Taxpayer asserts that since the exemption or resale certificates were signed and maintained on file by taxpayer, it is relieved from any further liability for sales and use tax.

During the audit, taxpayer was unable to provide several exemption certificates. The auditor was therefore unable to verify that those sales were eligible to be exempt from the sales tax. The relevant regulation is 45 IAC 2.2-8-12(b), which states:

> Unless the seller receives a properly completed exemption certificate the merchant must prove that sales tax was collected and remitted to the state or that the purchaser actually used the item for an exempt purpose. It is, therefore, very important to the seller to obtain an exemption certificate in order avoid the necessity for such proof. The mere filing of a Registered Retail Merchant Certificate number is not sufficient to relieve the seller of the responsibility to collect sales tax or prove exempt use by the buyer.

Since the taxpayer was unable to produce exemption certificates or other evidence that the sales in question were exempt from sales tax, the Department assessed sales tax on those items.

Taxpayer stated during hearing that it had located exemption certificates for some of its customers, and also stated that it could not find exemption certificates for three of its customers, conceding that it owed taxes on sales to those customers. Taxpayer submitted copies of three exemption certificates to support its position. Two of these are for the same customer. One of the forms for that customer is from Indiana and one is from another state. Since taxpayer did provide an Indiana exemption certificate, the out-of-state certificate is moot. The third form is also from the other state. As previously established, IC 6-5-8-8 provides that exemption certificates must be on forms and in the manner prescribed by the department. There is no provision for an exemption based on an out of state certificate.

FINDING

Taxpayer's protest is sustained to the extent the Indiana exemption certificate provided covers the audit period, and denied with regard to the out of state certificates.

II. Tax Administration – Projection Method

DISCUSSION

Taxpayer argues that the projection method used by the Department is fundamentally flawed and cannot be used to accurately and fairly assess the sales and use taxes for the period of the audit. Audit will review the projection methodology to determine if the

exceptions in the sample periods are applied in a manner that fairly represents the errors in the populations. The exceptions of the sample should be applied to the base from which the sample is drawn.

FINDING

Taxpayer's protest is sustained pending review by the Audit division.

III. Tax Administration – Penalty and Interest

DISCUSSION

Taxpayer protests any penalties and interest associated with these assessments on the grounds that it was resisting payment of taxes which it asserts were exempt transactions, and that it relied in good faith on the advice of counsel. IC 6-8.1-10-1(a) states:

If a person fails to file a return for any of the listed taxes, fails to pay the full amount of the tax shown on his return by the due date for the return or the payment, or incurs a deficiency upon determination by the department, the person is subject to interest on the nonpayment.

IC 6-8.1-10-1(e) explains that the department may not waive the interest imposed under this section. Therefore, the interest may not be waived. The Department did not impose penalties on these assessments.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980309.LOF

LETTER OF FINDINGS NUMBER: 98-0309
Use Tax
For Tax Periods 1993-1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Use Tax – Allocated General Expenses

Authority: IC 6-2.5-4-1; 45 IAC 2.2-3-4; 45 IAC 2.2-4-2

Taxpayer protests imposition of sales tax on general expenses paid to parent company.

II. Use Tax – Allocated Occupancy Charges

Authority: IC 6-2.5-4-4; 45 IAC 2.2-4-8

Taxpayer protests imposition of sales tax on occupancy charges paid to parent company.

III. Tax Administration – Negligence Penalty

Authority: 45 IAC 15-11-2

Taxpayer protests imposition of a ten percent (10%) negligence penalty.

STATEMENT OF FACTS

Taxpayer is in the business of buying, selling and holding educational loans. Taxpayer was incorporated in 1992 as a not-for-profit corporation, and applied for federal recognition of its exemption status in 1993. Taxpayer withdrew its application for exempt status in 1995. At that point, taxpayer filed financial institution tax returns to cover the period from its inception through the present. No use tax was paid with the returns.

In 1993 and 1994, taxpayer's parent company was a not-for-profit entity, and served as a common purchasing arm for its subsidiaries. In 1995 taxpayer was transferred from the first parent company to a second parent company. The second parent company was a taxable entity. The Indiana Department of State Revenue ("Department") conducted an audit of taxpayer covering tax years 1993 through 1996. The Department assessed use tax on items purchased by the parent corporations but used by taxpayer.

I. Use Tax – Allocated General Expenses

Taxpayer protests imposition of use tax on various administrative fees paid by taxpayer to its parent companies. The Department assessed use tax on taxpayer's allocated expenses exclusive of occupancy, including printing, copying, data processing and asset costs. These expenses were recouped by the parent companies through the administrative fees. Taxpayer believes the administrative fees are not subject to tax because they are for the provision of nontaxable services. Taxpayer refers to IC 6-2.5-4-1(e), which states:

The gross retail income received from selling at retail is only taxable under this article to the extent that the income represents:

(1) the price of the property transferred, without the rendition of any service; and

(2) except as provided in subsection (g), any bona fide charges which are made for preparation, fabrication, alteration, modification, finishing, completion, delivery, or other service performed in respect to the property transferred before its transfer and which are separately stated on the transferor's records.

Taxpayer states the services provided by its parent are not enumerated as taxable under Indiana law and any tangible personal

property transferred with the provision of these services are inconsequential.

In determining the use tax assessment for taxpayer, the Department relied on 45 IAC 2.2-3-4, which states:

Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction, and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana state gross retail tax has been collected at the point of purchase.

Since the original parent company is a not-for-profit entity, no gross retail tax was collected at the point of purchase and the items were used or otherwise consumed in Indiana. The second parent company is a for-profit entity, but it purchased supplies outside of Indiana, therefore no gross retail tax was collected on those items at the point of purchase and the items were used or otherwise consumed in Indiana.

Taxpayer claims the amount of tangible personal property transferred from its parent was inconsequential, under ten percent (10%), and was therefore exempt. The relevant regulation is 45 IAC 2.2-4-2(a), which states:

Professional services, personal services, and services in respect to property not owned by the person rendering such services are not "transactions of a retail merchant constituting selling at retail", and are not subject to gross retail tax. Where in conjunction with rendering professional services, personal services, or other services, the serviceman also transfers tangible personal property for a consideration, this will constitute a transaction of a retail merchant constituting selling at retail unless:

(1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;

(2) The tangible personal property purchased is used or consumed as a necessary incident to the service;

(3) The price charged for tangible personal property is inconsequential (not to exceed 10%) compared with the service charge; *and*

(4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition. (Emphasis added)

On its face, this exemption does not apply. All four elements must be satisfied for this exception to apply. It has been established that the parent companies did not pay gross retail tax or use tax on the tangible personal property at the time of acquisition.

At hearing, taxpayer asked who would collect the tax if the parent companies were not required to be listed as a retail merchant in order to collect the use tax from taxpayer. Taxpayer confuses the issue. The parent companies were not selling items to taxpayer; rather, the parent companies were purchasing items on behalf of the subsidiary.

The situation of the taxpayer and its parent corporations suggests the existence of an agency relationship in which the parent corporations obtained tangible personal property tax-free for the taxpayer's use which reimbursed the parent for the goods. Since the taxpayer is not an exempt entity, it should have paid sales or use tax on the goods purchased.

FINDING

Taxpayer's protest is denied.

II. Use Tax – Occupancy Allocations

Taxpayer protests imposition of use tax on various direct and indirect occupancy charges paid to the parent company. The Department assessed the direct occupancy charges based on the amount paid by taxpayer to the parent for building supplies, utilities and office maintenance. Taxpayer believes that the direct occupancy charges are substantively building rental charges and are exempt under IC 6-2.5-4-4, which states in pertinent part:

(a) A person is a retail merchant making a retail transaction when the person rents or furnishes rooms, lodgings, or other accommodations, such as booths, display spaces, banquet facilities, and cubicles or spaces used for adult relaxation, massage, modeling, dancing, or other entertainment to another person:

(1) if those rooms, lodgings, or accommodations are rented or furnished for periods of less than thirty (30) days;

Taxpayer believes that since the accommodations are rented for more than thirty days, they are exempt. A more succinct description of this exemption is found in 45 IAC 2.2-4-8(b), which states:

In general, the gross receipts from renting or furnishing accommodations are taxable. An accommodation which is rented for a period of thirty (30) days or more is not subject to the gross retail tax.

Taxpayer is correct that rental expenses for the offices it rents from the parent company are exempt, since they are rented for more than thirty days. The Department did not assess use tax on the rental costs allocated to taxpayer.

The assessment for direct occupancy charges included building supplies, utilities and office maintenance. The costs of office maintenance were reduced by fifty percent (50%) to exclude the costs of labor.

Taxpayer believes that the indirect occupancy charges are building management fees which are non-taxable services as explained in Issue I of this protest. As explained in Issue I, the nature of the relationship between taxpayer and the parent company is one where the parent is purchasing tangible personal property free of tax, as a not-for-profit organization, on behalf of taxpayer, which is a for-profit corporation.

Taxpayer states in its protest letter that at no time is the parent company selling building supplies, utilities or office maintenance to taxpayer, but only allocates the charges on its records to help it track its costs. As previously established, the parent is not selling theses items, but rather is purchasing items on behalf of its non-exempt subsidiary.

FINDING

Taxpayer's protest is denied.

III. Tax Administration – Negligence Penalty

Taxpayer protests imposition of a ten percent (10%) negligence penalty. Taxpayer was assessed use tax on direct purchases made for it by its parent corporation, and did not protest this assessment. Taxpayer believed the allocated expenses were for services, which would not be taxable. The Department waived penalties for the first two years of this audit, on the grounds that taxpayer was making a good faith effort to gain not-for-profit status from the federal government during those years.

The relevant regulation is 45 IAC 15-11-2(c), which states in part:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-2.1] if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, taxpayer has not demonstrated that it exercised ordinary business care and prudence in carrying out its duty to pay sales tax. Once taxpayer was no longer seeking not-for-profit status, it should have known that it could not receive tangible personal property from its not-for-profit parent company without paying use tax. Therefore, taxpayer has not affirmatively established reasonable cause.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02980499.LOF

LETTER OF FINDINGS NUMBER: 98-0499
Income Tax
Calendar Years 1992, 1993, 1994, and 1995

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

The negligence penalty was assessed on an income tax assessment resulting from a Department audit for the calendar years 1992, 1993, 1994, and 1995.

The taxpayer manufactures magnesium oxide and related products. In Indiana, the taxpayer has a sales office with four employees, and, maintains a public warehouse. In 1992, the taxpayer had a repair facility in Indiana.

I. Tax Administration – Penalty

DISCUSSION

The taxpayer argues the penalty should be waived as the error was not due to negligence and the tax returns were prepared by the former parent before the stock spin-off.

The Department points out that the tax issues are repeat issues from the previous audit. Further, the present corporation is liable for the actions of the former parent before the stock spin-off.

45 IAC 15-11-2(b) states, "Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer."

The Department finds the taxpayer was inattentive to tax duties. Inattention is negligence and negligence is subject to penalty. As such, the Department finds the penalty proper and denies the penalty protest.

FINDING

The taxpayer's penalty protest is denied.

DEPARTMENT OF STATE REVENUE

02980561.LOF

LETTER OF FINDINGS NUMBER: 98-0561
Gross Income Tax
For Tax Periods 1994-1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Gross Income Tax – High Rate Receipts

Authority: Gross Income Tax Department of Treasury et al. v. Harbison-Walker Refractories Co., 48 N.E.2d 834 (Ind. App. 1943); IC 6-2.1-2-1; 45 IAC 1-1-102

Taxpayer protests the classification of income at the high rate of gross income tax.

STATEMENT OF FACTS

Taxpayer is a diversified mineral resource company engaged in the manufacture and sale of refractories, minerals and insulating materials. The taxpayer also provides the service of relining steel industry ladles and degassers. The Department of Revenue ("Department") conducted an audit for the years 1994 and 1995. This audit included adjustments for Indiana labor income from the relining of ladles and degassers from the reported low rate to the high rate for gross income tax purposes. Taxpayer protests the adjustments for labor income from the lower rate to the higher rate.

I. Gross Income Tax – High Rate Receipts

Taxpayer protests the reclassification of receipts from labor cost from the low rate to the high rate. Taxpayer explains that the relining process involves: mixing refractory materials to specific densities, casting components for the vessels, installing reinforcements, and lining the vessels with refractories at certain temperatures. Also, some materials were installed under pressure, which required an additional heat application. Taxpayer's customers removed the equipment and reinstalled those items. Taxpayer contracted for the transportation of the empty vessels from the customer's location to taxpayer's plant.

In support of its protest, taxpayer raises IC 6-2.1-2-1(c)(1), which states:

"Wholesale sales" means any sale described in this subsection in which the purchaser is not a division, subdivision, agency, instrumentality, unit, or department of government:

…

(B) Sales of tangible personal property which is to be directly consumed in direct production by a purchaser in the business of producing tangible personal property by manufacturing, processing, refining, repairing, mining, agriculture, or horticulture.

Taxpayer also states that in the Harbison-Walker case, the court held that refractories consumed in direct production are taxed at the lower rate. Gross Income Tax Dept. of Treasury et al. v. Harbison-Walker Refractories Co. 48 N.E.2d 834, 837 (Ind. App. 1943). Taxpayer believes that since the refractory material is tangible personal property directly consumed in the production process it should be taxed at the lower rate.

The Department made an adjustment for Indiana labor income in this case. The refractory material remained taxed at the low rate. The Department relied on 45 IAC 1-1-102, which states in pertinent part:

When a taxpayer, acting as a "retail merchant" as defined above, supplies tangible personal property in connection with services performed on property belonging to another, the gross receipts from such services, regardless of when or where performed, are taxable at the higher rate. Gross receipts derived from any materials furnished under the contract are taxable at the lower rate.

The Department taxed the receipts from services performed on property belonging to another at the higher rate. The materials furnished were taxed at the lower rate.

Taxpayer protests the taxation of labor at the higher rate, but only provided information supporting the lower rate of tax for the refractory materials. The Department taxed the refractory materials at the lower rate. Taxpayer stated that it provided the services of mixing the materials, installing reinforcements, and lining the vessels. The Department properly adjusted the taxes on the labor at the higher rate, per 45 IAC 1-1-102.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04980720.LOF

LETTER OF FINDINGS NUMBER: 98-0720
Use Tax
For Calendar Years 1994, 1995, and 1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Use Tax – Imposition

Authority: 45 IAC 2.2-3-4; 45 IAC 2.2-3-8(a); 45 IAC 2.2-3-12; 45 IAC 2.2-3-19; 45 IAC 2.2-3-25

Taxpayer protests the imposition of use tax.

II. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer was audited for calendar years 1994, 1995, and 1996. Upon audit it was discovered that the taxpayer failed to remit use tax on clearly taxable items. Taxpayer also purchased a radio station. The previous owner had rented software to run the radio station. When the taxpayer purchased the radio station, they did not want the software and agreed to a buyout of the previous owner's software agreement. Communications with the lessor of the software, found the taxpayer agreed to the buyout amount of the software lease upon purchase of the radio station.

Taxpayer presented a letter from the lessor stating it received payments from the taxpayer totaling $11,100 as a negotiated settlement, to release taxpayer from any liability or responsibility for any and all terms or claims to an agreement signed by the original lessor and seller of the radio station. The letter further states that the taxpayer did not receive services or merchandise from the lessor regarding these payments and these payments did not involve the exercising of any option in the lease agreement between the original lessee and lessor. It further states that no agreement existed between lessor and the taxpayer. It was simply a settlement. There was no lease agreement between taxpayer and the original lessor.

I. Use Tax – Imposition

DISCUSSION

Taxpayer protests the assessment of use tax on a software lease used by the previous owners to run the radio station. Taxpayer agreed to a buyout of the software agreement and had no use for the software.

No lease agreement existed between taxpayer and lessor (collectively "the parties"); the transaction between the parties resulted from taxpayer's bulk purchase of the radio station. Further, the payments to the seller of the station were the result of a settlement agreement wherein the taxpayer would not be held liable or responsible for any and all terms or claims of an agreement between the lessor and the seller, i.e., the previous owner of the radio station. Taxpayer did not receive any taxable service or merchandise from this transaction. Taxpayer did not exercise any option in the lease agreement, as taxpayer had no privity with the original lease agreement.

The department finds no taxable transaction exists because the taxpayer was not a party to the lease. This payment may be taxable to the original owner, but not to this taxpayer.

FINDING

Taxpayer's protest is sustained.

ISSUE

II. Tax Administration – Penalty

DISCUSSION

Taxpayer requests all penalties be abated because it has always made every attempt to properly report and pay all taxes due and has implemented new procedures to report and pay tax on all taxable purchases in a timely manner.

Taxpayer's audit indicates it made a minimal amount of use tax payments in 1994 and none in 1995 and 1996. The Indiana Code and Regulations are clear regarding the self-assessment of tax where no tax is charged.

Taxpayer has not provided reasonable cause to allow the department to waive the penalty. Taxpayer should have had use tax procedures in effect to assure tax is paid.

FINDING

Taxpayer's protest is denied.

CONCLUSION

Taxpayer's protest is sustained for Issue I and denied for Issue II.

DEPARTMENT OF STATE REVENUE

02990116.LOF

LETTER OF FINDINGS NUMBER: 99-0116 IT
Adjusted Gross Income Tax – Net Operating Loss Deductions
For Tax Periods: 1994 through 1996

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Adjusted Gross Income Tax – Net Operating Loss Deductions

Authority: Ind. Code § 6-3-2-2.6; 45 IAC 3.1-1-9; 26 USCA § 338; *[Taxpayer] Privatization Act*, 45 U.S.C. § 1301 et seq., (1986)

Taxpayer protests proposed assessments of Indiana adjusted gross income tax based on the disallowance of net operating loss deductions for tax periods ending in 1994, 1995, and 1996.

STATEMENT OF FACTS

Taxpayer hauls freight by rail in Indiana. During the audit period (1994-1996), Taxpayer carried forward certain net operating losses (NOLs) to reduce (or eliminate) its reportable Indiana adjusted gross income. Audit disallowed these NOL deductions. Audit's decision resulted in proposed assessments of Indiana adjusted gross income tax for each year. Taxpayer protests the disallowance of its NOL deductions and the proposed assessments.

I. Adjusted Gross Income Tax – Net Operating Loss Deductions

DISCUSSION

In response to the failure of regional rail carriers (primarily in the Northeast and Midwest), Congress passed the Regional Rail Reorganization Act of 1973 (45 U.S.C. § 701 et seq.; hereinafter, the "Act"). Among its objectives, the Act established Taxpayer, a for-profit, quasi-governmental corporation (incorporated in Pennsylvania in 1975). The United States owned eighty-five percent (85%) of Taxpayer's common stock; Taxpayer's employees owned the remaining fifteen percent (15%). Notwithstanding seven billion dollars ($7,000,000,000) of federal investment, Taxpayer generated enormous losses. From 1976 through 1982, Taxpayer's operating losses exceeded two billion dollars ($2,000,000,000).

In response to Taxpayer's unprofitable operations, Congress enacted the Northeast Rail Service Act of 1981 ("NERSA") (45 U.S.C. § 1101 et seq.). This legislation exempted Taxpayer from state tax liabilities. Additionally, Congress served the Secretary of Transportation with notice to begin preparations for the sale of the federal government's interest in the beleaguered corporation. Taxpayer "turned" a modest profit and reported taxable income for tax periods ending in 1983 through 1986.

Given Taxpayer's continuing profitability coupled with the federal government's sizeable investment, Congress enacted the [Taxpayer] Privatization Act in 1986 (45 U.S.C. § 1301 et seq.) to facilitate the public sale of Taxpayer's federally-owned common stock. Additionally, the "new" publicly owned Taxpayer was to receive "special" tax treatment. Specifically, "[f]or periods after the public sale, for purposes of Title 26, **Taxpayer shall be treated as a new corporation which purchased all of its assets as of the beginning of the day after the date of the public sale for an amount equal to the deemed purchase price."** 45 U.S.C. § 1347(a)(1) (Supp.1987). (Emphasis added.) In other words, Congress, while forgiving Taxpayer's federal debt, prohibited Taxpayer from using its presale net operating losses to offset its post-sale federal income. Taxpayer—assuming continued profitability—would become a federal taxpayer. Additionally, Taxpayer's exemption from state tax liabilities was extinguished commencing January 1, 1987.

Taxpayer's state and federal post-sale tax returns (1994-1996) were reviewed by the Audit Division ("Audit) of the Indiana Department of Revenue ("Department"). Since Taxpayer, for federal income tax purposes, was prohibited from carrying forward any presale NOLs, the auditor determined a similar prohibition should apply for state income tax purposes.

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Taxpayer concisely states the contested issue: "[t]he only legal issue in this matter is whether, under INDIANA law, net operating losses incurred by [Taxpayer] during periods when its stock was owned by the Federal government may be carried forward to periods after its stock was sold in a public offering [on 4/2/87]."

Taxpayer notes that for tax periods ending 4/87 through 4/89, the Department accepted Taxpayer's use of the NOL deductions now in question.

However, the focus of Taxpayer's argument concerns the methodology used in computing Indiana's net operating losses and the effects of such use. Taxpayer explains:

[T]he federal statutes involved provide only that [Taxpayer] could not carry NOL's forward for purposes of calculating its

FEDERAL income tax in post-public offering tax years. The statutes are silent on whether such losses may be carried forward for STATE income tax purposes. States are free to apply their own law. Some States, by statute, specifically adopt the Federal calculation, without adjustment, as their own, and in those States no carry forward would be available for State income tax purposes. However, other States, including INDIANA, do not precisely follow the Federal definitions or the Federal calculations but make various adjustments to reflect their own policy considerations. Thus, there is no requirement that a Taxpayer's carry forwards for INDIANA purposes be the same as its carry forwards for Federal tax purposes—they may be higher or lower and the calculations may include or exclude different items. A Taxpayer may have a carry forward for Federal purposes but not for INDIANA purposes; conversely[,] a Taxpayer may have a carry forward for INDIANA purposes but not for Federal purposes. By the same measure, carry forwards calculated under INDIANA law will differ from those calculated under the law of a different State.

For these reasons, Taxpayer contends the "original NOL carry forward's [for tax periods ending 4/87 through 4/89] were properly computed and audited under INDIANA law [and such carry forwards should be recognized for the tax periods at issue]."

****

As an initial matter, the Department notes the carry forward of NOLs represents an exemption from Taxpayer's Indiana adjusted gross income. IC 6-3-2-2.6. Tax exemptions are to be strictly construed against Taxpayer (*Sony Music Entertainment, Inc. v. State Board of Tax Commissioners*, 681 N.E.2d 800,801 (Ind.Tax Ct. 1997)). Consequently, Taxpayer bears the burden of proving entitlement to the exemption (*Indianapolis Fruit Co. v. Department of State Revenue*, 691 N.E.2d 1379, 1383 (Ind.Tax Ct. 1998)). And more generally, "[t]he burden of proving that the proposed assessment is wrong rest with the person against whom the assessment is made. IC 6-8.1-5-1(b).

Ind. Code § 6-3-2-2.6 describes Indiana's four step formula used to calculate Indiana net operating losses. The preface to the state NOL computations (Ind. Code § 6-3-2-2.6(a), with emphasis added) states:

This section applies to a corporation or a nonresident person, for a particular taxable year, **if the taxpayer's adjusted gross income for that taxable year is reduced because of a deduction allowed under Section 172 of the Internal Revenue Code for a net operating loss**. For purposes of section 1 of this chapter, the taxpayer's adjusted gross income, for the particular taxable year, derived from sources within Indiana is the remainder determined under STEP FOUR of the following formula:

STEP ONE: Determine, in the manner prescribed in section 2 of this chapter, the taxpayer's adjusted gross income, for the taxable year, derived from sources within Indiana, **as calculated without the deduction for net operating losses provided by Section 172 of the Internal Revenue Code.**

STEP TWO: Determine, in the manner prescribed in subsection (b), **the amount of the taxpayer's net operating losses that are deductible for the taxable year under Section 172 of the Internal Revenue Code, as adjusted to reflect the modifications required by IC 6-3-1-3.5, and that are derived from sources within Indiana.**

STEP THREE: Enter the larger of zero (0) or the amount determined under STEP TWO.

STEP FOUR: Subtract the amount entered under STEP THREE from the amount determined under STEP ONE.

Indiana regulation 45 IAC 3.1-1-9 explains that "[t]he net operating loss as described in Internal Revenue Code § 172 is an allowable deduction for corporations in computing Indiana Adjusted Gross Income. **The amount of the loss which may be deducted is the Federal net operating loss after…**(emphasis added; computations omitted).

The cited statutory and regulatory language is unambiguous. The existence (if not the claim) of federal NOLs serves as predicate to the entitlement, computation, and subsequent deduction from Indiana adjust gross income of Indiana NOLs. The Department's findings, however, will not be premised on Taxpayer's lack of federal NOLs. A more fundamental flaw exists.

Pursuant to congressional authority, all the common stock owned by the federal government in Taxpayer (eighty-five percent of the total), was sold to the public. For purposes of federal taxation, this "privatization" created a new corporation.

For periods after the public sale, for purposes of Title 26, Taxpayer shall be treated as a new corporation which purchased all of its assets as of the beginning of the day after the date of the public sale for an amount equal to the deemed purchase price.

45 USCA §1347(a)(1).

Congress chose (i.e., elected) to treat the sale of Taxpayer stock as a sale of assets under section 338 of the Internal Revenue Code.

The deemed purchase price shall be allocated among the assets of Taxpayer in accordance with the temporary regulations prescribed under section 338 of Title 26….

45 USCA § 1347(a)(2).

(a) General rule.—For purposes of this subtitle, if a purchasing corporation makes an election under this section (or is treated under subsection (e) as having made such an election), then, in the case of any qualified stock purchase, the target corporation—

(1) shall be treated as having sold all of its assets at the close of the acquisition date at fair market value in a single transaction, and

(2) shall be treated as a new corporation which purchased all of the asset referred to in paragraph (1) as of the beginning of the day after the acquisition date.

26 USCA § 338.

Generally, Indiana tax laws coincide with the Internal Revenue Code. ("'Adjusted Gross Income' with respect to corporate Taxpayers is 'taxable income' as defined in [the] Internal Revenue Code—section 63 with three adjustments…45 IAC 3.1-1-8. "'Gross income' for Adjusted Gross Income Tax purposes is gross income as defined in Internal Revenue Code § 61." 45 IAC 3.1-1-19. "When used in IC 6-3, the term 'adjusted gross income' shall mean…[i]n the case of corporations, the same as 'taxable income' (as defined in Section 63 of the Internal Revenue Code) adjusted as follows…IC 6-3-1-3.5(b). See *Cooper Industries, Inc. v. Indiana Dept. of State Revenue*, 1996, 676 N.E.2d 1209. "To the extent the provisions apply to this article, regulations adopted under Section 7805(a) of the Internal Revenue Code and in effect on January 1, 1998, shall be regarded as rules adopted by the department under this article, unless the department adopts specific rules that supercede the regulation." IC 6-3-1-11(b).)

Since Congress chose to characterize the post-sale reincarnation of Taxpayer as a "new" corporation for federal income tax purposes, Indiana will do so for state income tax purposes.

An analogous situation is noted in 45 IAC 3.1-1-9(5), which states in part:

> When a corporate merger takes place or a new subsidiary is included in a consolidated Indiana Adjusted Gross Income Tax return, the Department follows the guidelines of the Internal Revenue Code as to treatment of net operating losses sustained by any of the corporations involved.

In this instance, the Department finds no reason to depart from the federal guidelines outlined in the [Taxpayer] Privatization Act (45 U.S.C. § 1301 et seq.).

The Department also notes that Taxpayer protested similar assessments proposed by the Illinois Department of Revenue. Illinois disallowed Taxpayer from carrying forward net operating losses incurred prior to the privatization of Taxpayer. In affirming the decision of the circuit court— which affirmed the Illinois Department of Revenue's denial of Taxpayer's NOL deductions—the Illinois Appellate Court closed with the following observation:

> We are not convinced that plaintiff [Taxpayer] has met this burden in the case at bar, as plaintiff cites no authority which supports its position that, following a fundamental corporate change pursuant to section 338 election, an entity is allowed to succeed to or retain certain tax attributes, such as net losses, for state purposes when such characteristics are patently extinguished for purposes of federal taxation.

Consolidation Rail Corporation et al v. The Department of Revenue, 688 N.E.2d 806, 813 (Ill.App.3d 1997).

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04990292.LOF

LETTER OF FINDINGS NUMBER: 99-0292
Use Tax
For Years 1994 – 1996

NOTICE: Under Ind. Code § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

I. Use Tax – Liability of Taxpayer for Use Tax on Purchases of Advertising Services

Authority: Ind. Code § 6-2.5-1-1; Ind. Admin. Code tit. 45, r. 2.2-1-1; Ind. Admin. Code tit. 45, r. 2.2-4-2

The taxpayer protests the assessment of use tax on purchases of advertising services.

STATEMENT OF FACTS

The taxpayer is an Indiana company and its principal business is the retail sale and installation of floor coverings. The retail business was sold during the audit period and no retail transactions were made after October 1, 1996. A sales and use tax audit for the period 1994 through 1996 was completed on July 18, 1997.

I. Use Tax – Liability of Taxpayer for Use Tax on Purchases of Advertising Services

DISCUSSION

The taxpayer was assessed use tax on the full amount paid for advertising materials and services performed by an out-of-state advertising agency. The agency was paid to create, print, and mail promotional materials to prospective customers in Indiana. No sales tax was charged by the agency for either materials or services. The taxpayer concedes that use tax is due on the materials that were purchased, but argues that it should not be assessed use tax on the services performed by the advertising agency. The taxpayer cites Ind. Admin. Code tit. 45, r. 2.2-4-2, which states that, generally, professional services are not subject to the gross retail tax but when tangible personal property is transferred along with the services, it is selling at retail and subject to the tax unless four conditions are met:

(1) The serviceman is in an occupation which primarily furnishes and sells services, as distinguished from tangible personal property;

(2) The tangible personal property purchased is used or consumed as a necessary incident to the service;

(3) The price charged for tangible personal property is inconsequential (not to exceed 10%) compared with the service charge; and

(4) The serviceman pays gross retail tax or use tax upon the tangible personal property at the time of acquisition.

Ind. Admin. Code tit. 45, r. 2.2-4-2(a).

This regulation does not, however, apply to the present circumstances. With the work it did for the taxpayer, the advertising agency was not primarily furnishing and selling services. The advertising agency produced tangible personal property, in the form of promotional materials, and sold those materials to the taxpayer.

Of the thirty-one advertising agency invoices submitted by the taxpayer, two of them show separate charges for postage, a service. Those are invoices #21082 and #21084, both dated July 26, 1994. The remaining invoices indicate that charges for property and services were combined. The taxpayer has submitted worksheets where the charges for the materials and the charges for services provided are separated. The worksheets, however, were completed by the taxpayer after receiving the invoices from the advertising agency and do not affect the nature of the transaction.

"'[U]nitary transaction' includes all items of personal property and services which are furnished under a single order or agreement and for which a total combined charge or price is calculated." Ind. Code § 6-2.5-1-1(a).

For purposes of the state gross retail tax and use tax, such taxes shall apply and be computed in respect to each retail unitary transaction. A unitary transaction shall include all items of property and/or services for which a total combined charge or selling price is computed for payment irrespective of the fact that services which would not otherwise be taxable are included in the charge or selling price.

Ind. Admin. Code tit. 45, r. 2.2-1-1(a).

The advertising agency invoices clearly show that the taxpayer's purchases were unitary transactions, and, thus, the entire charge on the invoices is subject to use tax. The amounts charged for postage on invoices #21082 and #21084 were not assessed use tax in the audit since those were separately stated charges for services. The remaining amount charged on each of those invoices is subject to use tax.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

02990445.LOF

LETTER OF FINDINGS NUMBER: 99-0445
Corporate Income Tax
For Tax Periods: 1994-1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

1. Adjusted Gross Income Tax – Addback of Property Taxes

Authority: IC 6-3-1-3.5(b)

Taxpayer protests the add-back of property taxes.

2. Adjusted Gross Income Tax – Net Operating Loss

Authority: IC 6-3-2-2.6

Taxpayer protests the calculation of net operating loss deduction.

STATEMENT OF FACTS

Taxpayer is a manufacturer of automobiles. After an audit for the tax period 1994-1997, Taxpayer was assessed additional adjusted gross income and supplemental net income taxes. Taxpayer timely protested the assessments and a hearing was held. Further facts will be presented as necessary.

1. Adjusted Gross Income Tax – Addback of Property Taxes

DISCUSSION

Taxpayer's first protest concerns the add back of property taxes. For taxable year 1994, Taxpayer filed an amended Indiana income tax return to modify the calculation of its adjusted gross income IC 6-3-1-3.5 (b) as follows:

In the case of corporations, the same as "taxable income" (as defined in Section 63 of the Internal Revenue Code) adjusted as follows:

(1) Subtract income that is exempt from taxation under IC 6-3 by the Constitution and statutes of the United States.

(2) Add an amount equal to any deduction or deductions allowed or allowable pursuant to Section 170 of the Internal Revenue Code.

(3) Add an amount equal to any deduction or deductions allowed or allowable pursuant to Section 63 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state of the United States or for taxes on property levied by any subdivision of any state of the United States.

(4) Subtract an amount equal to the amount included in the corporation's taxable income under Section 78 of the Internal Revenue Code.

Taxpayer amended its 1994 return to change the amount reflected as an add back of property taxes by not adding back the amount of property taxes which were classified for federal purposes as costs of goods sold. Taxpayer also did not add back those property taxes in its Indiana income tax returns for 1995-1996.

Taxpayer argues that the property taxes which are a component of costs of goods sold should not be added back since they are not deductions allowed pursuant to Section 63 of the Internal Revenue Code as follows.

(a) In General. – Except as provided in subsection (b), for purposes of this subtitle, the term "taxable income" means gross income minus the deductions allowed by this chapter (other than the standard deduction).

The capitalized property taxes, as part of the cost of goods sold, are deducted from Taxpayer's total receipts in determining Taxpayer's gross income. Therefore they are included in the gross income. When deductions are taken from the gross income to determine the "taxable income" as defined by this statute, the inclusion of the deductions in the gross income effectively includes those deductions in the term "taxable income" as defined by this statute.

Taxpayer contends that it does not have to add back property taxes because they are defined as nondeductible from "taxable income" as defined by the statute pursuant to the following provisions of Section 263 A as follows:

(a) Nondeductibility of Certain Direct and Indirect Costs.

(1) In general. –In the case of any property to which this section applies, any costs described in paragraph (2)—

(A) in the case of property which is inventory in the hands of the taxpayer, shall be included in inventory costs, and

(B) in the case of any other property, shall be capitalized.

(2) Allocable costs. – The costs described in this paragraph with respect to any property are-

(A) the direct costs of such property, and

(B) such property's proper share of those indirect costs (including taxes) part or all of which are allocable to such property.

Any cost which (but for this subsection) could not be taken into account in computing taxable income for any taxable year shall not be treated as a cost described in this paragraph.

Taxpayer is correct in that this provision does not allow a deduction of the property taxes after the determination of "taxable income" as defined by this statute. That does not negate the fact, however, that the property taxes were deducted in the determination of the gross income portion of the formula for determination of the "taxable income" as defined by the statute. Therefore the property taxes were effectively deducted and must be added back.

FINDING

Taxpayer's protest is denied.

2. Adjusted Gross Income Tax – Net Operating Loss

DISCUSSION

Taxpayer's second point of protest concerns the calculation and application of net operating losses. Net operating losses are calculated pursuant to the method set out in IC 6-3-2-2.6. The first step is determining the amount of federal net operating losses. The larger of the federal net operating loss and zero is determined. Indiana net operating losses are calculated by determining the amount of federal net operating losses attributable to revenue sources within Indiana. Those losses are deducted from the Indiana income. 45 IAC 3.1-1-9 provides an example of the calculation and application of corporate net operating losses. The Auditor followed this example and calculated the Indiana net operating losses correctly in determining the amount of tax owed by Taxpayer.

Taxpayer contends that the audit applied the net operating loss incorrectly by applying Indiana modifications in the year the loss was incurred and in every other year in which the net operating loss was used. Application of the net operating loss is clarified at 45 IAC 3.1-1-9 as follows:

The net operating loss as described in Internal Revenue Code Sec. 172 is an allowable deduction for corporations in computing Indiana Adjusted gross Income. The amount of the loss which may be deducted is the Federal net operating loss after:

(1) All modifications required under IC 6-3-1-3.5 (b);...

Under this Regulation, Indiana modifications are used to compute the Indiana adjusted gross income in the year of utilization of a net operating loss, prior to application of the loss. The loss is then to be adjusted in each year of utilization of the loss by the Indiana modifications of the year of the utilization of the net operating loss.

FINDING

Taxpayer's second point of protest is denied.

DEPARTMENT OF STATE REVENUE

4220000107.LOF

LETTER OF FINDINGS NUMBER: 00-0107 IFTA
International Fuel Tax Agreement (IFTA)
For Years 1996, 1997, and 1998

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. IFTA – Filing IFTA Returns

Authority: IC § 6-6-4.1-2; IC § 6-6-4.1-4(a); IC § 6-6-4.1-4.5; IFTA II K

Taxpayer protests audit assessment based on the state's failure to provide him with returns.

II. IFTA – Credit for Taxes Paid

Authority: IC § 6-6-4.1-4.5

Taxpayer protests that corporation did not receive credit for taxes on fuel paid for at the pump in 1996.

STATEMENT OF FACTS

Taxpayer is in the business of selling and delivering sand, stone, and gravel. Taxpayer operated subject vehicles and had been filing IFTA returns until 1996. In 1997 and 1998 the Department mailed, but taxpayer alleges he did not receive, the IFTA tax returns. In 1999 taxpayer asked at a district office about the taxpayer's IFTA account while obtaining his IRP plates. The staff person reported that the fuel account number did not come up on the computer and that taxpayer should reapply for an IFTA account. Taxpayer declined this suggestion and left.

I. IFTA – Filing IFTA Returns

DISCUSSION

Taxpayer asserts his failure to pay taxes was based on the state's failure to provide him with the appropriate tax returns. Leaving aside the factual question of what returns the state did or did not forward to the taxpayer, IC § 6-6-4.1-2 states vehicles subject to the motor carrier fuel tax law include a:

(5) truck having a gross weight or a declared gross weight greater than 26,000 pounds; and

(6) vehicle used in combination if the gross weight or the declared gross weight of the combination is greater than 26,000 pounds….

IFTA II K tracks with the Indiana statute's definition of a qualified vehicle as follows:

"Qualified Motor Vehicle" means a motor vehicle used, designed, or maintained for transportation of persons or property and:

(1) Having two axles and a gross vehicle weight or registered gross vehicle weight exceeding 26,000 pounds or 11,797 kilograms; or

(2) Having three or more axles regardless of weight; or

(3) Is used in combination when the weight of such combination exceeds 26,000 pounds or 11,797 kilograms gross vehicle or registered gross vehicle weight. "Qualified Motor Vehicle" does not include recreational vehicles.

Taxpayer makes no claim or argument that the vehicles operated by the taxpayer corporation are not subject to the tax assessed. The taxes in question are defined in relevant part by IC § 6-6-4.1-4(a):

A tax is imposed on the consumption of motor fuel by a carrier in its operations on highways in Indiana. The rate of this tax is the same rate per gallon as the rate per gallon at which special fuel is taxed under IC 6-6-2.5. The tax shall be paid quarterly by the carrier to the department on or before the last day of the month immediately following the quarter.

As well as IC § 6-6-4.1-4.5:

A surcharge tax is imposed on the consumption of motor fuel by a carrier in its operations on highways in Indiana. The rate of this surcharge tax is eleven cents ($0.11) per gallon. The tax shall be paid quarterly by the carrier to the department on or before the last day of the month immediately following the quarter.

Both of the above statutes place an explicit duty ("the tax shall be paid") on the taxpayer to provide payment of the tax without the state's assistance. Taxpayer does not cite any statute, regulation, or IFTA provision suggesting the state has a duty to provide the necessary forms or that a failure by the state to provide these forms nullifies the above cited statutes.

Inasmuch as taxpayer was paying and filing IFTA returns into 1996, taxpayer was aware of these taxes and the procedures for filing. As to the events outlined in the facts, taxpayer may not have received the IFTA forms, but this in no way relieves taxpayer of the aforementioned statutory duties.

FINDINGS

Taxpayer protest denied.

II. IFTA – Credit for Taxes Paid

DISCUSSION

In the hearing, taxpayer stated that all taxes were paid at the pump in 1996, that $0.16 went to the state and $0.24 to the Federal government from each gallon purchased at the pump, indicating taxpayer was not cognizant of the $0.11 surcharge imposed by IC § 6-6-4.1-4.5, which states in relevant part:

A surcharge tax is imposed on the consumption of motor fuel by a carrier in its operations on highways in Indiana. The rate of this surcharge tax is eleven cents ($0.11) per gallon. The tax shall be paid quarterly by the carrier to the department on or before the last day of the month immediately following the quarter.

A review of the IFTA Quarterly Report Schedule A (IFTA-101A) for the relevant quarters indicates taxpayer did receive $0.16 per gallon credit for fuel purchased at the pump. Taxpayer's confusion is based on the additional $0.11 surcharge for subject vehicles that is not collected at the pump. Inasmuch as a review of the audit indicates taxpayer received the $0.16 per gallon credit in the 1996 calculations and taxpayer cited no other area of deficient credits, the protest is not sustained.

FINDINGS

Taxpayer protest denied.

DEPARTMENT OF STATE REVENUE

0120000160.LOF

LETTER OF FINDINGS NUMBER: 00-0160 AGI
Adjusted Gross Income Tax
For Tax Periods: 1994

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

Adjusted Gross Income Tax – Imposition

Authority: IC 6-3-2-1; 26 U.S.C.A. Sec. 61(a); Thomas v. Indiana Department of Revenue, 675 N.E.2d 362 (Ind. Tax 1997); Snyder v. Indiana Department of Revenue, 723 N.E.2d 487 (Ind. Tax 2000)

Taxpayer protests the imposition of the adjusted gross income tax.

STATEMENT OF FACTS

The Indiana Department of Revenue issued Taxpayer a refund of taxes for 1994. The Indiana Department of Revenue determined that the refund was issued in error. Further facts will be provided as necessary.

Adjusted Gross Income Tax – Imposition

DISCUSSION

An adjusted gross income tax is imposed upon all Indiana residents. IC 6-3-2-1.Taxpayer argues that he has no Indiana

Adjusted Gross Income for 1994 and therefore does not owe any tax. Taxpayer notes that the Indiana Code borrows some of its definitions from the Internal Revenue Code. For instance, "gross income" is defined at IC 6-3-1-8 as having the meaning as defined by section 61(a) of the Internal Revenue Code." Section 61 (a) which states in part:

Except as otherwise provided in this subtitle, gross income means all income from whatever source derived, including (but not limited to) the following items:

(1) Compensation for services, including fees, commissions, fringe benefits, and similar items...

Taxpayer contends that since the word "wages" is not listed in Section 61, wages are not taxable income. Therefore he amended his federal return to enter "zero" on the line titled "Wages, Tips, other Compensation." He then entered his federal adjusted gross income of "zero" on his Indiana amended return. Following this erroneous logic, Taxpayer protested the assessment of additional tax, penalty and interest for 1997.

The Indiana Tax Court has disposed with arguments that wages do not constitute income. In Thomas v. Indiana Department of Revenue, 675 N.E.2d 362 (Ind. Tax 1997), the Tax Court stated:

[e]ven assuming the validity of Thomas's legal framework, monetary payments made in exchange for labor are clearly severed from labor and received or drawn by the recipient for his separate use, benefit, or disposal.

In Snyder v. Indiana Department of Revenue, 723 N.E.2d 487 (Ind. Tax 2000), the Court specifically states at page 491 that "wages are income for purposes of Indiana's adjusted gross income tax." Taxpayer's income is subject to the Indiana Adjusted Gross Income Tax.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220000251.LOF

LETTER OF FINDINGS NUMBER: 00-0251
Corporate Income Tax
For Tax Periods: 1996-1998

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE

Adjusted Gross Income Tax – Imposition

Authority: IC 6-3-2-1(b); 26 U.S.C. Sec. 63; IC 6-3-1-3.5(b)

Taxpayer protests the imposition of the tax on certain receipts.

STATEMENT OF FACTS

Taxpayer owns and operates several restaurants in Indiana and Ohio. After an audit, Taxpayer protested the assessment of additional Indiana Adjusted Gross Income Tax, interest and penalty. More facts will be provided as necessary.

Adjusted Gross Income Tax – Imposition

DISCUSSION

Taxpayer claimed the "credit for employer social security and medicare taxes paid on certain employee tips" on its federal income tax returns for fiscal years ending October 31, 1996 and 1998. This credit was equal to the its FICA obligation attributable to tips received exceeding those tips treated as wages for purposes of satisfying the minimum wage provisions of the Fair Labor Standards Act. Indiana has not adopted this credit. In order to claim this credit on its Indiana Adjusted Gross Income Tax return, Taxpayer deducted the amount of the credit from its Indiana adjusted gross income. Taxpayer protests the disallowance of this modification.

Indiana imposes an adjusted gross income tax on corporations. IC 6-3-2-1 (b). A corporation's adjusted gross income is the same as the corporation's "taxable income" as defined at 26 USC Sec. 63 with certain modifications. IC 6-3-1-3.5 (b). The federal credit which Taxpayer deducted from its Indiana adjusted gross income is not a statutorily mandated modification for Indiana Adjusted Gross Income Tax purposes.

FINDING

The taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220000290P.LOF

LETTER OF FINDINGS NUMBER: 00-0290P
Income Tax

Calendar Year 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer filed form IT-20 for calendar year 1997, under extension, and was assessed a penalty for late payment.

Taxpayer requests that the department waive the late payment penalty.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer was assessed a ten percent (10%) penalty because it paid its tax after the due date of the return.

Taxpayer, in a letter dated June 9, 2000 protested penalties assessed and stated it did not have preprinted estimated/extension forms sent them timely and were unclear of the filing requirements. The tax return is the taxpayer's initial Indiana return for which it remitted its full tax on October 15, 1998.

IC 6-8.1-10-2.1(a)(2) clearly assesses a penalty if a person fails to pay the full amount of tax shown on the person's return on or before the due date for the return. (The due date of the return is April 15). The tax was not paid until October. IC 6-8.1-6-1(a) clearly states that at least ninety percent (90%) of the tax that is reasonably expected to be due on the due date must be filed with the petition for a sixty-day (60) extension.

Taxpayer has not provided reasonable cause to allow a waiver of the penalty assessed.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0120000295P.LOF

LETTER OF FINDINGS NUMBER: 00-0295P
Individual Income Tax
Calendar Year 1998

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Late payment penalty

Authority: IC 6-8.1-10-2; 45 IAC 15-11-2

Taxpayer protests the penalty assessed for the late filing of its return.

STATEMENT OF FACTS

Taxpayer, in a letter dated June 26, 2000 protested the late filing penalty because it had not previously owed Indiana tax and its Federal Return was under a valid extension. Taxpayer filed its IT-40PNR return on June 12, 1999 with a balance of tax due in the amount of $5,541. On October 14, 1999, the Department issued its proposed assessment for penalty and interest.

I. Tax Administration – Penalty

DISCUSSION

At issue is whether the taxpayer had reasonable cause in failing to timely remit tax due.

Taxpayer made no payments until after the due date of the return. Taxpayer states it was not aware of any tax liability owed to the State of Indiana as of April 15, 1999, and, upon completion of its tax returns in early June of 1999, paid an Indiana tax liability of $5,541.

IC 6-8.1-10-2 (a) states:

If a person fails to file a return for any of the listed taxes or fails to pay the full amount of tax shown on his return on or before the due date for the return or payment, incurs, upon examination by the department, a deficiency which is due to negligence, or fails to timely remit any tax held in trust for the state, the person is subject to a penalty.

IC 6-8.1-6-1(c) states:

If the Internal Revenue Service allows a person an extension on his federal Income tax return, the corresponding due dates for the person's Indiana income Tax returns are automatically extended for the same period as the federal extension, plus thirty (30) days. However, the person must pay at least ninety percent (90%) of the Indiana income tax that is reasonably expected to be due on the original due date by that due date, or he may be subject to the penalties imposed for failure to pay the tax.

The property that generated the Indiana income was sold in 1997. Taxpayer should have remitted at least ninety percent (90%) of the tax due by April 15, 1998. Communication problems between the taxpayer and the partnership is not reasonable cause for failing to pay the tax due timely.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420000298P.LOF

LETTER OF FINDINGS NUMBER: 00-0298P
Sales Tax and Use Tax
For Calendar Years 1995, 1996, and 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer protests the penalty assessed for audit years 1995, 1996, and 1997 completed on February 22, 2000.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer failed to remit approximately forty-five percent (45%) of its use tax due. A review of the audit report indicates the assessments, which were higher, stemmed from the same issues as the prior audit report completed on October 28, 1994.

Taxpayer requests a waiver of penalties because it remits sales and use tax on a regular basis and files in a timely manner. Further taxpayer states that it had a significant increase in purchases to operate its manufacturing facilities in the State of Indiana and has improved its compliance reporting, continuing to implement and revise procedures as needed.

Taxpayer failed to pay tax on clearly taxable items, issues that were present in prior audits. The taxpayer was negligent in failing to self-assess and remit taxes and has not provided reasonable cause for failure to do so.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420000299P.LOF

LETTER OF FINDINGS NUMBER: 00-0299P
Sales and Use Tax
Calendar Years 1997 and 1998

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

II. Tax Administration – Interest

Authority: IC 6-8.1-10-1

Taxpayer protests the interest assessed.

STATEMENT OF FACTS

Taxpayer protests the penalty assessed on an audit completed on March 8, 2000.

Taxpayer failed to self assess use tax on clearly taxable items and had no use tax accrual system in place. Taxpayer also failed to report all of its taxable sales and did not keep accurate records.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer's audit report revealed that no use tax accrual system was in place. The taxpayer failed to self assess tax as required by statute.

Taxpayer merely states that the purchases were made out of state and it was misled by the vendors that told him he did not have to pay sales tax if he had a tax ID number.

Taxpayer, however, should be aware of Indiana Tax laws when doing business in this state. Failure to have a use tax accrual system in place constitutes negligence.

FINDING

Taxpayer's protest is denied.

II. Tax Administration - Interest

DISCUSSION

Taxpayer protests the interest assessed.

The Department has not authority to waive interest.

FINDING

Taxpayer's protest is denied.

CONCLUSION

Taxpayer's protest is denied for Issues I and II.

DEPARTMENT OF STATE REVENUE

0420000303P.LOF

LETTER OF FINDINGS NUMBER: 00-0303P
Sales Tax
For the Month Ending May 31, 2000

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer protests the penalty assessed for failing to timely remit sales tax for May 2000.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer failed to timely remit sales tax for May 2000. The department disallowed the collection allowance and assessed a penalty.

Taxpayer requests a waiver of penalties because the person responsible for the payment was ill on the 19th of June. On June 20, the payment was processed through the bank and the Department received it on June 21, 2000.

A review of taxpayer's payment history indicates it had several late payment penalties from 1992 through 1996. A taxpayer has twenty days after the close of the period to remit its tax timely. Procedures should have been in place to assure no further late payments. The taxpayer was negligent in failing to timely remit the sales tax collected and has not provided reasonable cause for failure to do so.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420000304P.LOF

LETTER OF FINDINGS NUMBER: 00-0304P
Sales and Use Tax
Calendar Years 1997, 1998, and 1999

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer protests the penalty assessed on an audit completed on April 5, 2000.

Taxpayer failed to self assess use tax on clearly taxable items and had no use tax accrual system in place for 1998. Taxpayer was previously audited on October 11, 1991 and January 28, 1988 and some of the same issues were present.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer's audit report revealed that the taxpayer failed to remit use tax on thirty-one percent (31%), one hundred percent (100%), and seventy-five percent (75%) of its taxable purchases in 1997, 1998, and 1999 respectively although it had prior audits with similar issues. The taxpayer failed to self assess as required by statute and was aware that tax was due.

Taxpayer merely states that it makes many purchases throughout a given year and the audit revealed very few purchases that it failed to report for use tax.

Taxpayer, however, is aware that use tax is due and should have remitted the tax. Failure to do so constitutes negligence.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420000305P.LOF

LETTER OF FINDINGS NUMBER: 00-0305P
Use Tax
Calendar Years 1997 and 1998

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer manufactures a variety of equipment including overhead and rear projection screens, computer carts, stands, monitor mounts, lectern stands and cabinets. At audit, it was determined that the taxpayer failed to pay tax on computers, office supplies, forklifts, janitorial supplies, subscriptions, and other clearly taxable items. Taxpayer was previously audited in 1995 with the same

or similar issues.

Taxpayer failed to remit use tax on clearly taxable purchases although it had a use tax accrual system in place.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer's audit report revealed that it failed to remit use tax on clearly taxable items that were issues in a prior audit. The current audit assessed tax in excess of $30,000 for a two-year period while the prior audit assessed almost $14,000 for a three-year period.

Taxpayer states it was going through an exhausting system implementation to get ready for the year 2000 and a turnover of key financial personnel. A penalty waiver is requested.

Taxpayer made no attempt to self assess use tax on taxable purchases that were issues in a prior audit. The purchases for which no use tax was accrued or paid amounted to forty percent (40%) and seventy-two percent (72%) of the use tax due for calendar years 1997 and 1998 respectively. Taxpayer did not provide reasonable cause to allow a waiver of the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

2920000308.LOF

LETTER OF FINDINGS NUMBER: 00-0308 CG
Charity Gaming

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Charity Gaming – Management and Conduct of Events

Authority: IC 4-32-9-15

The Blues Society of Indiana d/b/a Northwest Blues Bingo (hereinafter referred to as Petitioner) protests the Indiana Department of State Revenue's imposition of a civil penalty for contracting in violation of IC 4-32-9-15.

II. Charity Gaming – Operator Membership Requirement

Authority: IC 4-32-9-28

The Petitioner protests the Department's imposition of a civil penalty for violating IC 4-32-9-28.

III. Charity Gaming – Worker Membership Requirement

Authority: IC 4-32-9-29

The Petitioner protests the Department's imposition of a civil penalty for violating IC 4-32-9-29.

IV. Charity Gaming – Remuneration of Operators and Workers

Authority: IC 4-32-9-25; 45 IAC 18-3-2

The Petitioner protests the Department's imposition of a civil penalty for allowing workers to accept tips from patrons violating IC 4-32-9-25.

V. Charity Gaming – Posting of Signage

Authority: 45 IAC 18-3-2

The Petitioner protests the Department's imposition of a civil penalty for failure to post a "no tipping" sign in violation of 45 IAC 18-3-2.

VI. Charity Gaming – Participation of Operators and Workers in Events

Authority: IC 4-32-9-27; 45 IAC 18-3-2

The Petitioner protests the Department's imposition of a civil penalty for allowing workers to participate in charity gaming in violation of IC 4-32-9-27.

VII. Charity Gaming – Prize Limits

Authority: IC 4-32-9-33

The Petitioner protests the Department's imposition of a civil penalty for exceeding the prize pay outs as set forth in IC 4-32-9-33.

VIII. Charity Gaming – Grounds for Penalties

Authority: IC 4-32-12-1(4) & (5); IC 4-32-9-15

The Petitioner protests the revocation of its charity gaming license and the subsequent suspension from conducting charity gaming for five (5) years.

STATEMENT OF FACTS

The Department's Criminal Investigation Division (CID) conducted an investigation of the Petitioner's organization. As a result

of the investigation, the Department issued a letter denying the issuance of Petitioner's charity gaming license. The letter was hand delivered to Petitioner's business on July 17, 2000, by one of the Department's investigators. The Petitioner protested the Department's denial, of its license to conduct charity gaming, in a letter dated July 17, 2000. An Administrative hearing in the above referenced matter was held July 21, 2000. On July 28, 2000, the Department received the transcript of the hearing.

I. Charity Gaming – Management and Conduct of Events

DISCUSSION

According to the Department's investigation the Petitioner entered into an agreement in 1994 with Mr. & Mrs. "S" (hereinafter referred to as "The Operators") who were to operate the Petitioner's charity gaming operations. The Operators agreed to finance the beginning of the gaming operation in exchange for sixty percent (60%) of the gaming profits. The Operators as part of the agreement located, rented, and paid for the repairs of Petitioner's bingo hall. The Operators also rented another site to operate bingo for the Petitioner. The Operators hired an architect to recommend repairs to the current bingo hall and paid a total of thirty-three thousand dollars ($33,000) for the repairs. All of these decisions were made by the Operators, without consulting any member or officer of the Petitioner's organization.

The Operators were the actual lessees of the current location which housed the Petitioner's charity gaming. The Petitioner became the sub-lessee. The original lease between the owner of the property and the Operators was for ($2,619) plus incidentals. The sub-lease was for considerably less. However, if the Petitioner used the current location for any activity other than charity gaming, the Petitioner was charged extra. The rent paid by the Petitioner to the Operators was greater than the amounts due and owing on the original lease thereby creating a profit for the Operators while they were operating the Petitioner's charity gaming operations. It also appears that the Operators paid the entire amount of rent due and owing on the original lease and the sub-lease to the owner from the Petitioner's bank account.

Indiana Code section 4-32-9-15 states, "A qualified organization may not contract or otherwise enter into an agreement with an individual, a corporation, a partnership, a limited liability company, or other association to conduct an allowable event for the benefit of the organization."

At hearing the Petitioner's representative stated, "When all this investigation was done, … were we not in fact, told that we weren't considered to be a partner in a scam here, and that the Department of Revenue…had no interest in pursuing the Blues Society… in 1998? (Record at 29).

The Department's witness in order to clarify the situation stated:

> … I told you as long as you were straightening out the bingo, you had no part in what was going on before, that we could certainly take into consideration that you guys were trying to clean up the bingo hall. And that definitely was taken into consideration.
>
> However, as I went on with my investigation, that was not the case for the entire thing. You had violated several rules of your own, and that is when we decided that the Blues was also responsible, not only the [Operators]. (Record at 29 & 30).

Pursuant to IC 6-8.1-5-1, the Department's findings in this matter constitute prima facie evidence that the Department's findings are valid. The burden of proving that the findings are wrong rests with the person against whom the findings are made. See Portland Summer Festival v. Department of Revenue, 624 N.E.2d 45 (Ind.App. 5 Dist. 1993).

It is clear that the Petitioner was cooperating with the Department's investigation but subsequent investigations found continued violations by the Petitioner (additional violations to be discussed in the findings below). The Petitioner did not offer any evidence either written or oral to contradict the Department's findings that the Petitioner entered into an agreement with the Operators to conduct their charity gaming events.

FINDING

The Petitioner's protest is denied.

II. Charity Gaming – Operator Membership Requirement

DISCUSSION

The Operators acted as operators even though they had not been members for at least one (1) year as is required by IC 4-32-9-28. Indiana Code section 4-32-9-28 states, "An operator must be a member in good standing of the qualified organization that is conducting the allowable event for at least one (1) year at the time of the allowable event."

Pursuant to IC 6-8.1-5-1, the Department's findings in this matter constitute prima facie evidence that the Department's findings are valid. The burden of proving that the findings are wrong rests with the person against whom the findings are made. See Portland Summer Festival v. Department of Revenue, 624 N.E.2d 45 (Ind.App. 5 Dist. 1993).

The Petitioner did not offer any evidence either written or oral to contradict the Department's findings that the Petitioner's operators had not been members of the organization for at least one (1) year in violation of IC 4-32-9-28.

FINDING

The Petitioner's protest is denied.

III. Charity Gaming – Worker Membership Requirement

DISCUSSION

The Petitioner violated IC 4-32-9-29 by allowing workers who were not members for at least thirty (30) days to work at events.

Indiana Code section 4-32-9-29 states, "A worker must be a member in good standing of a qualified organization that is conducting an allowable event for at least thirty (30) days at the time of the allowable event."

Pursuant to IC 6-8.1-5-1, the Department's findings in this matter constitute prima facie evidence that the Department's findings are valid. The burden of proving that the findings are wrong rests with the person against whom the findings are made. See Portland Summer Festival v. Department of Revenue, 624 N.E.2d 45 (Ind.App. 5 Dist. 1993).

The Petitioner did not offer any evidence either written or oral to contradict the Department's findings that the Petitioner allowed workers who were not members for at least thirty (30) days to work at events in violation of IC 4-32-9-29.

FINDING

The Petitioner's protest is denied.

IV. Charity Gaming – Remuneration of Operators and Workers

DISCUSSION

On three (3) separate occasions, the Department's investigator observed workers taking tips from players in violation of IC 4-32-9-25; 45 IAC 18-3-2(i). Indiana Code section 4-32-9-25 states:

Except as provided in subsection (b), an operator or a worker may not receive remuneration for:

(1) preparing for;
(2) conducting;
(3) assisting in conducting;
(4) cleaning up after; or
(5) taking any other action in connection with;

an allowable event.

(b) A qualified organization that conducts an allowable event may:

(1) provide meals for the operators and workers during the allowable event; and
(2) provide recognition dinners and social events for the operators and workers; if the value of the meals and social events does not constitute a significant inducement to participate in the conduct of the allowable event.

45 IAC 18-3-2(i) provides in pertinent part, "…Also, an organization cannot pay the operator or workers of an allowable event, including tips from the players."

Pursuant to IC 6-8.1-5-1, the Department's findings in this matter constitute prima facie evidence that the Department's findings are valid. The burden of proving that the findings are wrong rests with the person against whom the findings are made. See Portland Summer Festival v. Department of Revenue, 624 N.E.2d 45 (Ind.App. 5 Dist. 1993).

The Petitioner did not offer any evidence either written or oral to contradict the Department's findings that workers were taking tips from players in violation of IC 4-32-9-25 and 45 IAC 18-3-2(i).

FINDING

The Petitioner's protest is denied.

V. Charity Gaming – Posting of Signage

DISCUSSION

The Department's investigator frequented the Petitioner's hall on three occasions (November 27, 1997; January 21, 1998; and January 14, 2000). The Department's investigator observed, during the course of her investigation, the lack of a sign indicating that tipping is not allowed in violation of 45 IAC 18-3-2(i), which provides in pertinent part, "…A legible sign of adequate dimension must be prominently posted during an event stating that the operator and workers are not allowed to accept tips."

Pursuant to IC 6-8.1-5-1, the Department's findings in this matter constitute prima facie evidence that the Department's findings are valid. The burden of proving that the findings are wrong rests with the person against whom the findings are made. See Portland Summer Festival v. Department of Revenue, 624 N.E.2d 45 (Ind.App. 5 Dist. 1993).

The Petitioner stated during the hearing, "…May the 11th when we put the (" … ") out, we closed down to clean the place up, get rid of their stuff and repaint. We found… that there was a huge calendar hung over the tipping sign…."(Record at 47). The Petitioner goes on to state that, "…The day we opened up, the tipping sign has remained at the deal desk…." (Record at 47). It is clear from the record that once the Petitioner's representatives began to operate their own facility the signs were posted, but prior to that they were covered up intentionally.

FINDING

The Petitioner's protest is denied.

VI. Charity Gaming – Participation of Operators and Workers in Events

DISCUSSION

The Department's investigator observed workers and operators purchasing pull-tabs, opening them, and collecting the prize money. The workers and operators continued to play until all the pull-tab seals were completely sold out. Indiana Code section 4-32-9-27 states, "An operator or a worker may not directly or indirectly participate, other than in a capacity as operator or worker, in an allowable event that the operator or worker is conducting."

Pursuant to IC 6-8.1-5-1, the Department's findings in this matter constitute prima facie evidence that the Department's findings

are valid. The burden of proving that the findings are wrong rests with the person against whom the findings are made. See Portland Summer Festival v. Department of Revenue, 624 N.E.2d 45 (Ind.App. 5 Dist. 1993).

The Petitioner on cross-examination asked the Department's witness, "…You stated the first two times you were there [November 27, 1997 and January 21, 1998], that the gambling continued well into the night past the bingo time?" (Record at 41). The witness responded, "Yes" (Record at 41). The witness was then asked, "Can you tell us if that was the case when you were there on January 14, 2000?" (Record at 41). The witness's response was, "No…" (Record at 41).

The Petitioner did not offer any other evidence either written or oral to contradict the Department's findings that workers and operators were purchasing pull-tabs, opening them, collecting the prize money, and playing until all the pull-tab seals were completely sold out in violation of IC 4-32-9-27. While it is clear from the testimony of the Department's witness that the Petitioner discontinued selling pull tabs at the proper time on the night of January 14, 2000. That does not negate the fact that workers and operators were participating in the games and also that the games were played beyond their ending time on the two other occasions where the Department's investigator was present.

FINDING

The Petitioner's protest is denied.

VII. Charity Gaming – Prize Limits

DISCUSSION

The last time the Department's investigator observed the Petitioner, the pull-tab prize pay out on four (4) different games totaled five hundred dollars ($500) or greater exceeding the three hundred dollar ($300) limitation as set forth in IC 4-32-9-33. Indiana Code section 4-32-9-33(b) states, "A single prize awarded for one (1) winning ticket in a pull tab, punchboard, or tip board game may not exceed three hundred dollars ($300)."

The Petitioner's Exhibits 1, 2, 3, 4, & 5 were a representative sample of the types of games offered by the Petitioner. The Petitioner also explained how the games were played and administered. However, the evidence does not correspond with the games that were made part of the Department's investigation.

Pursuant to IC 6-8.1-5-1, the Department's findings in this matter constitute prima facie evidence that the Department's findings are valid. The burden of proving that the findings are wrong rests with the person against whom the findings are made. See Portland Summer Festival v. Department of Revenue, 624 N.E.2d 45 (Ind.App. 5 Dist. 1993).

The Petitioner had the opportunity through discovery to determine which games were under scrutiny by the Department, but failed to avail themselves of their right to view the Department's records in order to adequately prepare a response to the Department's actions.

FINDING

The Petitioner's protest is denied.

VIII. Charity Gaming – Grounds for Penalties

DISCUSSION

In addition to the forgoing penalties, the Department revoked and suspended Petitioner's license for five (5) years for what is termed "egregious conduct" in violation of IC 4-32-12-1(4) & (5) for participating in contracting and undertaking to deceive the Department by representing that the Operators and workers were members when they were not. Indiana Code section 4-32-12-1 states, "….(4) Commission of a fraud, deceit, or misrepresentation.(5) Conduct prejudicial to public confidence in the department."

The revocation of Petitioner's license and a five (5) year suspension is well within the Department's authority pursuant to IC 4-32-12-3.

FINDING

The Petitioner's protest is denied.

DEPARTMENT OF STATE REVENUE

0420000309P.LOF

LETTER OF FINDINGS NUMBER: 00-0309P
Sales and Use Tax
Calendar Years 1995, 1996, 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer protests the penalty assessed on a supplemental audit completed on June 6, 2000.

Taxpayer was assessed a negligence penalty because if failed to have a use tax accrual system in place. Taxpayer also failed to charge, collect, and remit sales tax for the sales of cleaning products.

I. Tax Administration – Penalty

DISCUSSION

At issue is whether the taxpayer was negligent in failing to remit use tax due.

Taxpayer failed to remit use tax on clearly taxable items and had no use tax accrual system in place.

Taxpayer states that it was unaware of Indiana Use Tax Regulations prior to the audit and has established a program of sales/use tax training for its divisions. Due to the lack of awareness of Indiana use tax rules, not intentional disregard of such rules, it requests an abatement of penalties.

Taxpayer has not provided reasonable cause for failing to comply with Indiana Sales and Use Tax statutes. Failure to make itself aware of Indiana tax laws when doing business in the state is considered negligence.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0220000322P.LOF

LETTER OF FINDINGS NUMBER: 00-0322P
Gross Income Tax – Penalty
For Calendar Years 1994, 1995, 1996, and 1997

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer was audited for calendar years 1994, 1995, 1996, and 1997. Upon audit it was discovered that the taxpayer failed to report and pay tax on gross income.

Taxpayer protests the penalty and states that reasonable cause exists because it has had an excellent record in complying with Indiana's tax statutes, has been a god corporate citizen, and during the audit had cooperated fully with the auditor. It has also changed its filing procedures in order to reflect the changes made as a result of the audit.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer states reasonable cause exists because it has always exercised due diligence in complying with the income tax rules and has cooperated fully with the auditor.

Taxpayer was assessed a negligence penalty because it failed to report gross income. Taxpayer operates three sales offices in the state with thirteen personnel, and payroll in excess of one million dollars. Taxpayer should have made itself aware of the tax laws of Indiana when doing business in the state. The assessment amounts to approximately eighty percent (80%) to one hundred percent (100%) of the tax due. Taxpayer has not provided reasonable cause to allow a waiver of the penalty.

The department finds that a negligence penalty is proper.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420000323P.LOF

LETTER OF FINDINGS NUMBER: 00-0323P
Use Tax
Calendar Years 1995, 1996, 1997, and 1998

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of

publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer protests the penalty assessed on an audit completed on April 10, 2000.

Taxpayer failed to remit tax on clearly taxable items such as tools and equipment used outside of production, i.e. computer and office equipment, materials for raw material storage, grinders used to sharpen production tools, warehousing supplies, strapping machine utilized for shipping, etc.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer's audit report revealed that it failed to self assess use tax on clearly taxable items. The taxpayer failed to self assess as required by statute and was made aware in a prior audit that use tax should be self assessed. Taxpayer failed to self assess tax on over eleven percent (11%) of its clearly taxable purchases, therefore the penalty is appropriate.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

0420000329P.LOF

LETTER OF FINDINGS NUMBER: 00-0329P
Use Tax
Calendar Years 1996, 1997, and 1998

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUE(S)

I. Tax Administration – Penalty

Authority: IC 6-8.1-10-2.1(d); 45 IAC 15-11-2

Taxpayer protests the penalty assessed.

STATEMENT OF FACTS

Taxpayer is diversified in gift sales and a publisher. At audit, it was determined that the taxpayer failed to pay tax on capital acquisitions, fixtures, computers, office supplies, subscriptions, and other clearly taxable items. Taxpayer was previously audited in 1993 with the same or similar issues.

Taxpayer failed to remit use tax on clearly taxable purchases although it had a use tax accrual system in place.

I. Tax Administration – Penalty

DISCUSSION

Taxpayer's audit report revealed that it failed to remit use tax on clearly taxable items that were issues in a prior audit. The current audit revealed that taxpayer failed to remit use tax on forty-nine percent (49%), sixty-four percent (64%), and sixty-eight percent (68%) of its use tax for 1996, 1997, and 1998 respectively.

Taxpayer states it was substantially in compliance for the audit period and cooperated with the auditor. Further, it has made the necessary changes to avoid future underpayment of taxes in the areas indicated in the audit. Taxpayer requests a waiver of penalties based upon the foregoing facts.

Taxpayer made little attempt to self assess use tax on taxable purchases that were issues in a prior audit. The purchases for which no use tax was accrued or paid amounted to fifty percent or more in the audit period. Taxpayer did not provide reasonable cause to allow a waiver of the penalty.

FINDING

Taxpayer's protest is denied.

DEPARTMENT OF STATE REVENUE

04950730.SLOF
04960337.SLOF
04960338.SLOF

SUPPLEMENTAL LETTERS OF FINDINGS NUMBER:
95-0730, 96-0337, 96-0338
Taxability of Electrical Energy Consumed in Food Production
For the Periods 1992 through 1994

NOTICE: Under Ind. Code § 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales/Use Tax Exemption for Utilities Consumed in Food Production – Microwave Ovens

Authority: Ind. Code § 6-2.5-4-5; Ind. Code § 6-2.5-5-5.1; Ind. Code § 6-8.1-5-1; Indiana Department of Revenue Sales Tax Information Bulletin #55 (May 31, 1989)

The taxpayer protests the partial denial of a sales tax exemption for utilities consumed by microwave ovens used in its restaurants**.**

II. Assessment of Taxes – Accuracy of the Audit Report

Authority: Ind. Code § 6-8.1-5-1

The taxpayer protests the accuracy of the auditor's report.

STATEMENT OF FACTS

The taxpayer is an Indiana corporation that owns and operates three (3) restaurants in Indiana, located in the towns of Huntington, Angola, and Wabash. Sales and use tax audits were completed on two of the restaurants on August 11, 1995, and on the third on September 7, 1995. The audits covered the tax years 1992 through 1994. As a result of the audits, the taxpayer was assessed use tax on a percentage of gas and electric utilities consumed at the restaurants.

A Letter of Findings was issued on December 30, 1999. On January 31, 2000, the taxpayer requested a rehearing. The request was granted and a rehearing was held on May 30, 2000. At the rehearing, the taxpayer protested the partial use tax exemption for energy consumed by its microwave ovens. According to the taxpayer, the restaurants' microwaves are used solely for food production purposes and should be granted full exemption from use tax. The taxpayer also protested the accuracy of the utility studies contained in the audit report.

I. Sales/Use Tax Exemption for Utilities Consumed in Food Production – Microwave Ovens

DISCUSSION

The taxpayer maintains that the microwave ovens in its three restaurants are used exclusively for food production and, therefore, should be 100 % exempt from use tax. The taxpayer has not offered any evidence supporting its position. This issue was addressed again during the rehearing. The taxpayer maintains that the microwave ovens are used only to cook food, not to thaw or defrost food.

Furnishing or selling electrical energy for commercial or domestic consumption constitutes making a retail transaction. Ind. Code § 6-2.5-4-5(b). Therefore, normal energy consumption requires the energy seller to collect and remit sales tax at the time the energy is sold. However, if, in the course of business, the electrical energy is directly consumed in the direct production of tangible personal property, the electrical energy is exempt from state gross retail tax. Ind. Code § 6-2.5-5-5.1.

Indiana Department of Revenue Sales Tax Information Bulletin #55 (May 31, 1989) states, "Restaurant food heating or cooling is taxable unless it is used in the actual production and creation of food." Utilities consumed in cooking food are exempt. The auditor granted a partial exemption for the electrical energy consumed in the operation of the taxpayer's microwave ovens based on an estimate of how the ovens were used. The auditor found that the ovens were used partially for thawing or reheating, and partially for cooking - i.e. the creation of food. The taxpayer has not submitted evidence to support its claim of full exemption for electrical energy consumed by the microwave ovens. The taxpayer has the burden of proving the assessment is wrong. Ind. Code § 6-8.1-5-1(b). The taxpayer has not met its burden in this case.

FINDING

The taxpayer's protest is denied.

II. Assessment of Taxes – Accuracy of the Audit Report

DISCUSSION

The taxpayer protests the accuracy of the auditor's report, specifically the figures used in the utility studies performed at the taxpayer's three restaurants in Huntington, Angola, and Wabash, Indiana. "The notice of proposed assessment is *prima facie* evidence that the department's claim for the unpaid tax is valid. The burden of proving that the proposed assessment is wrong rests with the person against whom the proposed assessment is made." Ind. Code § 6-8.1-5-1(b). The taxpayer was sustained in the Letter of Findings regarding a discrepancy between the amount of electrical energy consumed as shown on the utility bills for the Huntington restaurant and the amount used in the audit calculation.

Since the issuance of the Letter of Findings, the taxpayer has submitted additional evidence supporting its claim in the form of copies of 1992 electric utility bills for the Angola location. The bills for the Angola location show 281,480 total kilowatt hours consumed while the audit report indicated 346,353 kilowatt hours were used. Although copies of the electric bills for the Wabash restaurant are not available, the taxpayer claims that they would be similar to the bills for the other two locations.

The natural gas utility studies for both the Huntington and Wabash restaurants show that the majority of the gas used was consumed in the production of food. This enabled those restaurants to qualify for a predominant use exemption of 100%. According to the utility study, the Angola restaurant did not meet the requirement for the predominant use exemption. The difference is in the percentage deducted from therms used in production for higher sales volume during the summer. While the Huntington and Wabash restaurants showed average deductions of 5.07% and 4.57% for each year of the audit period, the Angola restaurant had an average deduction of 20.73%. The apparent discrepancies in the electric utility studies for the Angola and Wabash restaurants, and the natural gas utility study for the Angola restaurant, will be addressed in a supplemental audit.

FINDING

The taxpayer's protest is sustained with regard to the accuracy of the electric utility studies for the Angola and Wabash restaurants and the natural gas utility study for the Angola restaurant, pending audit verification.

DEPARTMENT OF STATE REVENUE

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SUPPLEMENTAL LETTER OF FINDINGS NUMBER: 97-0164
Sales and Use Tax
For the Years: 1992, 1993, 1994, 1995

NOTICE: Under IC 4-22-7-7, this document is required to be published in the Indiana Register and is effective on its date of publication. It shall remain in effect until the date it is superseded or deleted by the publication of a new document in the Indiana Register. The publication of this document will provide the general public with information about the Department's official position concerning a specific issue.

ISSUES

I. Sales/Use Tax – Market Surveys and Reports

Authority: 45 IAC 2.2-4-2

The Taxpayer protests the Department's assessment of sales/use tax on market surveys and reports.

II. Sales/Use Tax – License and Service Agreements

Authority: IC 6-2.5-4-6; IC 6-2.5-4-11

The Taxpayer protests the Department's assessment of sales/use tax on fees paid to receive radio and television feeds.

STATEMENT OF FACTS

The Taxpayer is an Indiana corporation consisting of divisions which primarily own and operate television and radio stations or which produce radio or television broadcasts. An audit was conducted for sales/use tax for the periods of 1992, 1993, 1994 and 1995. During the audit, the Taxpayer was assessed sales/use tax on market surveys and reports it uses to determine viewer ratings. Taxpayer contends sales/use tax assessments were also proposed on its purchase of licensing agreements for programming feeds (broadcast transmission via satellite). More facts will be provided as necessary.

I. Sales/Use Tax – Market Surveys and Reports

DISCUSSION

The Taxpayer was assessed sales/use tax on its market surveys and reports. It relies on a Revenue Ruling, requested by a representative of the Taxpayer, which states that market surveys are exempt from sales tax if the surveys fall within 45 IAC 2.2-4-2. Upon further review by the Department, the Taxpayer has demonstrated their compliance with this Ruling. Therefore, their protest is sustained.

FINDING

The Taxpayer's protest is sustained.

II. Sales/Use Tax – License and Service Agreements

DISCUSSION

The Taxpayer asserts that it was assessed sales/use tax for receiving television and radio programming feeds for broadcast purposes. The Department agrees that the programming feeds are not analogous to the reception of cable television or telecommunications service because the charge represents a license fee to re-broadcast a transmission. Consequently, the feeds are not taxable under IC 6-2.5-4-6 or IC 6-2.5-4-11.

The auditor asserts that no tax was assessed on programming feeds. Taxpayer asserts that one invoice subjected to tax was for programming feeds. However, Taxpayer has not provided a copy of the invoice.

FINDING

The Taxpayer's protest is denied. The Department agrees that programming feeds are not taxable. However, the Taxpayer has been unable to document that tax was assessed on any such items.

DEPARTMENT OF STATE REVENUE
REVENUE RULING #2000-06IT
September 1, 2000

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ISSUES

I. Gross Income Tax – Application of Indiana Gross Income Tax to Investment Income

Authority: 45 IAC 1.1-6-2

The taxpayer requests the Department to rule on the application of gross income tax to its investment income.

II. Adjusted Gross Income Tax – Application of Indiana Adjusted Gross Income Tax to Indiana Insurance Companies

Authority: IC 6-3-8-2; IC 27-1-18-2; IC 6-3-2-2.8

The taxpayer requests the Department to rule on the application of adjusted gross income tax to Indiana insurance companies.

STATEMENT OF FACTS

The taxpayer is incorporated in the state of Indiana and is domesticated in Indiana with the Department of Insurance. The taxpayer conducts business in all states as well as in foreign countries. The taxpayer maintains its home office and headquarters in New Jersey.

The taxpayer maintains a branch office in Indiana that performs insurance underwriting, claims processing, customer service, and premium collection activities. Management decisions made by employees of the Indiana branch are limited to only those activities above and are performed solely for Indiana policyholders. The taxpayer maintains branch office operations in other states that perform similar activities for policyholders in that particular state. The premiums collected by the branch operations are immediately transferred to the taxpayer's treasury operations located at the home office in New Jersey. These treasury funds then become immediately available for investment by the taxpayer's investment operations department that is also located in New Jersey. All of the investment policy and investment decisions are made from the New Jersey location. All gross receipts derived from the investment activity are received at the New Jersey location. The Indiana branch office personnel are evaluated for compensation on the basis of their underwriting ability and not on the basis of investment income earned since they have no connection to nor do they have any control over the investments.

The principal officers of the taxpayer do not reside in Indiana. Management and policy decisions affecting the taxpayers operations are made from the taxpayer's headquarters in New Jersey. One member of the taxpayer's board of directors is an Indiana resident; however, all other directors reside outside of Indiana. In addition, the board of director meetings are held at a location that is outside of Indiana. The Company books and records are maintained and located at the taxpayer's headquarters in New Jersey.

DISCUSSION – ISSUE #1

Rule 45 IAC 1.1-6-2 provides in part;

(c) Receipts derived from an intangible are not included in gross income under the following situations:

(2) The intangible does not form an integral part of a trade or business situated and regularly carried on at a business situs in Indiana, and the taxpayer's commercial domicile is located outside Indiana.

Investment income is an integral part of an insurance company's business, however, in the taxpayer's case, the income from the intangible investments does not form an integral part of a trade or business situated and regularly carried on at a business situs in Indiana. The activities associated with the taxpayer's business situs in Indiana involve underwriting, claims processing, customer service, and collection of premium from Indiana produced business. There is no investment activity conducted from the taxpayer's Indiana business situs, nor does any employee of the taxpayer's Indiana business situs have any control over the investment activity. The lone incidental activity in Indiana is the collection of premium from Indiana produced business and the subsequent transfer of

those amounts to the taxpayer's treasury operations at the home office in New Jersey where at that point they become available for the investment operations department of the taxpayer. The taxpayer's investment operation department makes all material investment policy and investment decisions including those decisions surrounding the acquisition and disposals of investments. All receipts from investment activity are received at the home office location in New Jersey.

The taxpayer's commercial domicile is located outside of Indiana. Major activities and business functions of the entire company, i.e., executive management, administrative, legal and finance are performed at the taxpayer's home office and headquarters located in New Jersey. Executive management decisions affecting global business operations originate from the taxpayer's headquarters in New Jersey. The principal officers and executives maintain their residence and offices outside of Indiana. The taxpayer's books and records are maintained and located at the taxpayer's home office and headquarters located in New Jersey. In addition, the board of director's meetings are held at a location outside of Indiana.

Here then, it is clear that the taxpayer's intangible income does not form an integral part of a trade or business situated and regularly carried on a business situs in Indiana, and the taxpayer's commercial domicile is located outside Indiana, hence, the taxpayers income derived from investments is not subject to Indiana gross income tax.

RULING – ISSUE #1

The Department rules that the taxpayer's income derived from investments is not subject to Indiana gross income tax.

DISCUSSION – ISSUE #2

IC 6-3-8-2(a) states that domestic insurance companies organized under the laws of the State of Indiana are exempt from tax imposed on adjusted gross income pursuant to IC 6-3-2-1 (imposition statute) under the provisions of IC 27-1-18-2 or IC 6-3-2-2.8(4). IC 6-3-2-2.8(4) states that insurance companies subject to tax under IC 27-1-18-2 are not subject to Indiana adjusted gross income tax. IC 27-1-18-2 provides that a domestic insurance company is subject to Indiana gross premium privilege tax, however, the domestic insurance company may elect on an annual basis to not pay "premium tax", but rather, pay Indiana gross income tax. Indiana insurance companies, including the taxpayer, therefore, are not subject to Indiana adjusted gross income tax.

RULING – ISSUE #2

The Department rules that Indiana insurance companies, including the taxpayer, are not subject to Indiana adjusted gross income tax.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances, as stated herein, are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling, a change in a statute, a regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.